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Welcome to the Autumn 2008 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 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:

- New hope for foreign investment: the Limited Partnerships Act comes into force;
- Free trade with China: a summary of what's ahead;
- Suppliers beware: take the extra step and register your security interest;
- Proposed changes to the Financial Advisers Bill;
- Law change makes it easier for local authorities to re-enter the public debt-securities market;
- Price control amendments: more or less control;
- New copyright law for the 21st Century;
- Challenges to Transpower's North Island grid upgrade continue.

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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.

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Commercial business law

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Commercial business law

New hope for foreign investment: the Limited Partnerships Act comes into force

After a long period of consultation and consideration, the Limited Partnerships Act 2008 came into force on 2 May 2008. In this article, partner Anna Buchly explores the key features of limited partnerships under the Act.

In the 1980s, the investment vehicle of choice for many venture capitalists was New Zealand's special partnership structure. Times moved on and, for some time now, special partnerships have been considered too restrictive and outdated.

Through the introduction of the new limited partnership regime, New Zealand's regulatory regime has been brought into line with a number of other jurisdictions.

Limited partnerships are recognised by many as the internationally preferred vehicle for investment into a foreign country for two principal reasons. First, most allow investors to limit their exposure to liability to the amount of their investment. Second, there is usually a corresponding tax regime in place to provide flow-through tax treatment to partners of gains and losses. This allows the foreign investor to recognise those gains and losses in their home jurisdiction.

The nuts and bolts of New Zealand's new limited partnership regime have been assembled by reviewing and adopting the "best practice" from jurisdictions which have had similar regimes in place for some time. These include the United States (Delaware and California), Australia (New South Wales), Jersey, Guernsey and the United Kingdom.

Principal features of a limited partnership under the Act

Status

Under the Act, limited partnerships are treated as a hybrid of a company and a partnership. Limited partnerships are separate legal entities but are transparent for New Zealand tax purposes (like general partnerships).

Subject to the Act, a limited partnership can carry on any business or activity and enter into any transaction and, for the purposes of doing so, the limited partnership has full rights and privileges.

Partners

For a limited partnership to be registered it must be composed of general partners and limited partners. A partnership must have at least one general partner and one limited partner at all times. A person may not be both a general partner and a limited partner of a limited partnership at the same time.

The general partners are responsible for the management of the limited partnership, whereas limited partners are passive investors and are not entitled to take any part in management outside certain specified activities or "safe harbours". The general partner may however change to a limited partner, and vice versa, at any time.

General Partners

A person will become a general partner once their name is entered as general partner on the register of limited partnerships maintained by the Registrar of Companies. Consequently the names and addresses of each general partner are publicly obtainable.

As well as being responsible for managing the particular business of the limited partnership, the general partner has a number of specific administrative responsibilities under the Act. Failure to carry out these responsibilities is an offence, subject to a summary conviction and a fine.

A general partner also has fiduciary duties under the Act, unless these are excluded by the limited partnership agreement. These fiduciary duties mirror the fiduciary duties of partners in a standard partnership under the Partnership Act 1908. In addition, partners in a general partnership have been held

to owe each other an overriding duty to observe the utmost good faith and fairness in dealings with each other. Arguably this will also apply to general partners in a limited partnership.

A general partner will be jointly and severally liable with the limited partnership and other general partners for debts and liabilities or for any wrongs or omissions of the limited partnership while that person is in the role of general partner. Unless a limited partnership agreement stipulates otherwise, this liability will be residual and the general partner will only become liable if the limited partnership itself is not able to satisfy the unpaid debts or liabilities.

The general partner has the authority to bind the limited partnership and acts as an agent of the limited partnership for the purpose of business. This authority only extends to where the transaction comes within the business of the limited partnership as determined by the general partners, the Act and the limited partnership agreement. However, the general partner is not an agent of any limited partner or other general partners.

Limited Partners

Like a general partner, to become a limited partner a person's name must be entered on the register of limited partnerships maintained by the Registrar of Companies. However, the details of a limited partner are not publicly available and are subject to strict confidentiality requirements, with only the Registrar being able to search them. This anonymity exists to encourage greater investment in the limited partnership.

A limited partner has no authority to bind the limited partnership and is not an agent of the partnership or any other partner. Further, a limited partner does not owe a fiduciary duty to the limited partnership.

One aspect of the Act which is the subject of some uncertainty provides that a limited partner must not be involved in the management of the limited partnership (the so-called "control rule"). Although management is not defined in the Act, some guidance is provided through the provisions of the Act. The Schedule to the Act lists activities which do not constitute taking part in management of a limited partnership (known as "safe harbours"). These activities can generally be characterised as high-level supervisory or consulting activities, rather than day-to-day management activities.

Where the limited partner *does not* take part in the management of the limited partnership, the liability of the limited partner is limited to the extent of their contribution to the partnership. However, when a debt or liability to a third party is incurred, a limited partner will be liable to the same extent as a general partner if:

- (a) the limited partner took part in management;
- (b) the third party knew that the limited partner took part in management; and
- (c) the third party believed on reasonable grounds that the limited partner was a general partner.

The limited partner will not have the benefit of residual liability that the general partner has. The limited partner will also be liable to the other partners if the limited partnership suffers loss from the breach. This full liability for any losses incurred creates a substantial risk to the limited partner, although the third party will have to show that it knew that the limited partner took part in management and it believed on reasonable grounds that the limited partner was a general partner. It may be hard to satisfy those conditions.

The limited partners are somewhat protected by the "safe harbours". But these "safe harbours" must be listed in the limited partnership agreement for the limited partners to have the right to participate in them.

Capital contribution and the partnership interest

The Act entitles both general partners and limited partners to make capital contributions to the limited partnership. A contribution is not mandatory and will be subject to the terms of the limited partnership agreement. The capital contribution is the share of the assets contributed by a partner, and the contribution can take any form. However, any loan by a partner to the limited partnership is not a capital contribution.

Upon a capital contribution, a partner has a right to distributions and any other benefit conferred by the limited partnership agreement. This partnership interest will be classified as a participatory security under the Securities Act 1983. Consequently, when an offer to participate as a limited partner is made to the public, that offer must comply with the Securities Act requirements of an offer of participatory securities,

and the limited partnership will require a statutory supervisor to be appointed under the Securities Act. This requirement is likely to mean that limited partnerships will be limited to investment vehicles for habitual investors and other investors who would not be considered members of the public.

The right to distributions on the basis of a capital contribution is broadly dealt with under the Act. It could include payment to a general partner to cover costs for the day-to-day running of the limited partnership. As a consequence, it is recommended that the size, manner, and frequency of distributions are dealt with in the limited partnership agreement. The Act requires that a distribution be authorised in writing by each general partner, who must be satisfied on reasonable grounds that immediately after the payment of the distribution the limited partnership will be solvent. A solvency test that must be considered before there can be an authorised distribution is specified in the Act, and is in substance the same as the solvency test of the Companies Act 1993. A partner who receives a distribution, knowing that immediately after the distribution the solvency test would not be satisfied by the limited partnership, is liable to repay that distribution. The period of liability to repay the distribution can be specified in the limited partnership agreement.

A general partner will be responsible for ensuring that financial statements for the limited partnership are completed within five months of the balance date of the limited partnership. The limited partnership will not have to report the prepared financial statements unless deemed an "issuer" under the Financial Reporting Act 1993.

Limited Partnership Agreement

A limited partnership must, upon registration, have a written limited partnership agreement. The agreement has the effect of a contract between the limited partnership, each general partner and each limited partner. The Act requires that certain matters must be provided for in a limited partnership agreement, including:

- any restrictions on assignment or disposal of a partner's partnership interest and the nature of those restrictions;
- any restrictions on the business or other activities of the limited partnership;
- the entitlement of partners to distributions;
- whether and in what circumstances a general partner can compete with the limited partnership;
- when meetings are required and the procedure for meetings;
- how partners can leave the limited partnership, whether a partner can be expelled and how a new partner is admitted; and
- how and when the limited partnership can be terminated.

The limited partnership agreement can provide for other matters, so long as they are consistent with the provisions of the Act.

Any partners entering into the limited partnership after initial registration will be bound by the limited partnership agreement. The new partners may be required to acknowledge this by signing a deed of adherence.

Registration

Setting up a limited partnership is relatively easy. The Companies Office is responsible for administration of the Act and maintaining the electronic register of partnerships. To protect the liability of its limited partners, a limited partnership should not commence trading or incur debt until it is registered. Failure to register may result in the partnership being treated as a standard partnership.

To register the limited partnership, the Companies Office requires a consent form from the general partner and a certificate from the applicant that a limited partnership agreement has been entered into that complies with the Act.

A limited partnership has unlimited duration subject to the terms of its limited partnership agreement and the termination events listed in the Act. To come to an end, it must be deregistered.

Termination and deregistration

A limited partnership will end when it is deregistered on the completion of a winding up or termination. Certain terminating events are outlined in the Act and act as automatic triggers towards dissolution. If the limited partnership wishes to terminate at a specific point it may specify its own terminating event within the limited partnership agreement. Upon a terminating event, the general partner retains limited authority to bind the partnership, and the rights and obligations of the partners will remain only as far as necessary to wind up the limited partnership and complete any unfinished transactions at the time of the terminating event.

Where the limited partnership has no debts or liabilities and the surplus assets have been distributed, it can be wound up by a general partner. However, where debts and liabilities do exist upon a terminating event, the limited partnership can only be wound up by appointment of a liquidator either by a resolution of the limited partnership or by the court upon an application of a general partner, a limited partner, a creditor or the Registrar. The limited partnership will be deregistered when its name has been removed from the register by the Registrar of Companies. Such deregistration may be requested by a limited partner (upon resolution of the limited partnership) or a general partner.

The Registrar can restore a limited partnership to the register on application of either a general partner, a limited partner, a creditor of the limited partnership, a liquidator or receiver of the property of the partnership. The Registrar of Companies must be satisfied that at the time the limited partnership was deregistered it was still carrying on business, was a party to legal proceedings, or was in receivership, or liquidation or both.

Tax considerations

The introduction of the limited partnership regime in New Zealand led the Government to amend the provisions of the Income Tax Act 2007 dealing with partnership taxation. As a result, the Taxation (Limited Partnership) Act 2008 was enacted at the same time as the Act, and deals with tax treatment of both general and limited partnerships. The key changes include:

- clarification of the flow-through taxation approach for partnerships (including limited partnerships);
- no longer any ability to stream different types of income/gain to different partners;
- new rules clarifying the effect of the entry and exit of partners;
- partners are deemed to have the status/intention of the partnership in relation to partnership property; and
- net loss flow-through restrictions will apply to limited partners of a limited partnership. Generally, a limited partner's share of the partnership net loss can only be utilised to the extent of the amount at risk in the partnership.

New regime for overseas limited partnerships

Part 3 of the Limited Partnerships Act 2008 also introduces new requirements for overseas limited partnerships which carry on business in New Zealand. This includes a requirement for such overseas limited partnerships to register with the Registrar of Companies and to file an annual return.

The Act provides a three month "grace" period for the registration of overseas limited partnerships that were carrying on business in New Zealand prior to the commencement of the Act. All other overseas limited partnerships carrying on business in New Zealand must register with the Companies Office within 10 working days of commencing business in New Zealand.

Prescribed forms for [registering an overseas limited partnership](#) and for filing an annual return are available online at the [Companies Office website](#). Each annual return must also be accompanied by the relevant additional prescribed form if there are any changes to the partners, addresses or name of the overseas limited partnership.

For further information, refer to the new Limited Partnerships website launched by the Companies Office in February 2008 (www.limitedpartnerships.govt.nz).

Commercial business law

Free trade with China: a summary of what's ahead

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New Zealand and China completed negotiations and signed a Free Trade Agreement in Beijing on 7 April 2008. The full text of the New Zealand-China Free Trade Agreement is available on the dedicated website maintained by the Ministry of Foreign Affairs and Trade (MFAT) www.chinafta.govt.nz

The MFAT website also contains a comprehensive guide, *Navigating China*, which is designed to assist New Zealand businesses to manage business opportunities in China.

Bilateral and multilateral Free Trade Agreements (FTAs) are, in part, a response to the slow progress of the World Trade Organisation's efforts to liberalise global trade. In a New Zealand context, our first and best known FTA was the Australia-New Zealand Closer Economic Relations Agreement (CER) signed in 1983. As CER has demonstrated, FTAs are not intended to be a static arrangement and 20 years after it was first signed, CER continues to evolve as New Zealand and Australia develop the concept of a single trans-Tasman market for goods and services.

Implementation

The signing of the NZ-China FTA is followed by an implementation process and the FTA is expected to come into force on 1 October 2008. It has become common for bilateral agreements to be signed between governments prior to being submitted to domestic parliamentary processes in order to show commitment to the agreement.

Generally, trade agreements such as FTAs are not directly incorporated into New Zealand law. Instead, in order to come into force, New Zealand's domestic parliamentary procedures require the text of the FTA, along with the texts of the Memorandum of Understanding on Labour Cooperation (MOU) and the Environment Cooperation Agreement (ECA) - which are treaties between New Zealand and China - and the associated National Interest Analysis to be presented to Parliament for consideration, and released publicly.

The FTA, MOU and ECA will be examined by a select committee which may call for public submissions. After the select committee process, legislation to implement New Zealand's obligations under the FTA (eg. tariff cuts) will need to be passed before New Zealand is able to ratify the FTA.

The final step in the process is an exchange of notes with China, indicating the completion of domestic legal procedures so that the FTA can be entered into force in both countries.

Structure

The FTA comprises the FTA itself along with 14 annexes, two side letters, an arrangement governing the establishment of a working holiday scheme and the MOU and ECA.

The FTA also includes a number of significant exceptions that enable either party to enact laws to protect national security and other interests.

The FTA can also be amended by agreement in writing by the parties, with amendments coming into force 60 days after the parties have completed the necessary domestic legal procedures. In keeping with most bilateral agreements, the FTA can also be terminated by a party by giving 180 days' written notice of the intention to terminate.

While specific provisions in the FTA have review processes built into them, the FTA does not contain a review mechanism. Instead, the parties have established the New Zealand - China Free Trade Area Joint Commission which may meet at the level of senior officials, or ministers to consider matters relating to the

implementation of the FTA and conduct a review of the operation and implementation of the FTA within two years of entry into force of the FTA (and at least every three years thereafter). The FTA Joint Commission may consider proposals to amend the FTA, oversee its further elaboration and consider issues referred to it by the committees and working groups established under the FTA or by either party.

Bell Gully Guide

Bell Gully's guide is intended to provide an overview of the NZ-China FTA. More information is contained on the MFAT website referred to above, including the text of the various annexes, side letters and arrangements that must be read in conjunction with the FTA.

[Click here to view a copy of the guide.](#)

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Commercial business law

Suppliers beware: take the extra step and register your security interest

Two recent High Court decisions highlight the importance for suppliers of ensuring that they have an enforceable security interest in goods supplied to customers for which they have not been paid.

It is common practice for suppliers to try to secure payment for goods supplied to a customer by including either a retention of title clause or a more general security interest in their terms of trade or supply agreements. However, without taking the extra step to perfect those security interests by registering a financial statement on the Personal Property Securities Register (PPSR), the supplier will not be afforded any protection against non-payment where there are other creditors with competing security interests over the same goods.

In two recent High Court cases involving suppliers caught up in the receivership and subsequent liquidation of EXFTX Limited - formerly Feltex Carpets Limited, neither supplier had registered financial statements on the PPSR for their supply arrangements. In order to avoid being merely an unsecured creditor for the amounts owed to them, they had to argue that their respective arrangements did not fall under the Personal Property Securities Act 1999 (PPSA) regime. Both were unsuccessful.

Had these suppliers taken full advantage of the PPSA regime by registering a purchase money security interest (PMSI), they would have had what is called a "super-priority" over all other secured parties, including both of Feltex's banks' general security interests.

Segard Masurel (NZ) Ltd v Nicol¹

The facts

Segard routinely supplied wool to Feltex under the terms of a supply agreement. The supply agreement provided that "payment will be made in cash on delivery on the contractual date of delivery, or actual received date if delivery has been delayed, or receipt of invoice if invoice not received until after delivery date." In the weeks leading up to Feltex being placed in receivership, Segard provided three batches of wool for which payment was not made on delivery. Segard had, however, allowed the wool to remain on Feltex's premises after receiving an undertaking that the wool would be stored separately and not touched until payment was made.

When Feltex was placed in liquidation, Segard applied for summary judgment in the District Court for the outstanding amount of the invoices on the ground that since payment was not received at the time of delivery, title had not passed to Feltex and the goods were being held on trust for Segard until payment was made.

The District Court's decision

The District Court found that Segard had unconditionally appropriated title in the wool to Feltex upon delivery and that Segard was simply an unsecured creditor of Feltex.

As an unsecured creditor, Segard's interest in the wool was defeated by the perfected security interests of the two banks, which both had registered financing statements on the PPSR for the securities they had been granted over Feltex's assets.

The District Court also held that if title had not passed to Feltex on delivery of the wool, in any event the supply agreement would have been a conditional sale agreement which would have been caught by the PPSA.

¹ [12 February 2008] HC, Auckland, CIV 2007-404-003603.

The High Court's decision

Segard appealed to the High Court which upheld the District Court's findings on both grounds.

On the question of whether Segard had unconditionally appropriated title in the wool to Feltex on delivery, the court noted that:

- there was no express retention of title clause in the supply agreement;
- the supply agreement contemplated that payment could be made after delivery of the wool where an invoice is not received on the delivery date; and
- factual evidence indicated that, as was the case regarding the outstanding invoices, Segard did not usually insist that payment occur at the time of delivery.

As such, under the Sales of Goods Act, Segard is deemed to have unconditionally appropriated the wool to the contract and title in the wool passed to Feltex on delivery.

On the second issue, the High Court agreed with Segard that it was not necessary as a matter of business efficacy to imply a retention of title term into the supply agreement where Segard chose not to exercise its right to insist on payment at the time of delivery. However, the court did not agree with Segard that the supply agreement was simply an agreement for cash on delivery, rather than a conditional sale agreement.

In the High Court's view, by failing to insist on payment on delivery, Segard was effectively granting credit when the goods were delivered without payment. Further, in order for this part of Segard's argument to succeed, the court noted that it must be assumed that title in the wool had been retained by an implied term to that effect. Accordingly, there was an agreement to sell, subject to retention of title, and the transaction therefore fell within section 17(3) of the PPSA so as to be a security interest under the PPSA.

***JS Brooksbank & Co (Australasia) Limited v EXFTX Limited (in receivership and liquidation)*²**

The facts

In the second case, JS Brooksbank (JSB) also supplied wool to Feltex.

The parties entered into a supply agreement which included a security interest in the form of a retention of title clause. If JSB had perfected its security interest by registering it on the PPSR, it would have amounted to a PMSI and had priority over Feltex's other secured creditors.

JSB did not do this and instead tried to protect its position by requiring payment before delivery. The supply agreement provided that delivery of wool was only to be made on receipt of cleared funds and that upon receipt of notification of cleared funds, unconditional ownership of wool would pass to Feltex. The wool brokers were therefore only authorised to release the wool to Feltex upon receipt from JSB of a Buyer Delivery Order.

Subsequently, an employee of Feltex mistakenly wrote to wool brokers requesting that they release wool owned by JSB to Feltex when payment had not yet been made. Some brokers then released wool to Feltex without JSB's authority.

JSB applied for judgment against Feltex claiming that Feltex had deliberately requested delivery of the wool disregarding JSB's right to possession and that Feltex's subsequent failure to return the wool, which had been set aside on JSB's request, amounted to conversion.

Feltex opposed the application on the basis the JSB had an unperfected security interest in the wool, which was subject to the perfected security interest of Feltex's bank.

JSB contended that Feltex's affirmative defence was not relevant given that JSB had no security interest in the goods because Feltex had no right to an interest in the wool until payment had been received under the terms of the supply agreement.

² [2008] NZBLC 102, 113.

High Court's decision

The court disagreed with JSB's submission that no security interest had been created in the wool supplied to Feltex, stating that where goods have been delivered to the customer without receipt of payment for such goods and where the supplier has retained title in such goods, then a security interest arises under the PPSA. The court stated that it is irrelevant whether possession has passed to the customer by mistake or by agreement and it affirmed that conditional sale agreements, including an agreement to sell subject to retention of title, are expressly included within the definition of a security interest in the PPSA.

The court noted that although an element of consensus is necessary for the creation of a security interest, such consensus is only required in relation to the transaction pursuant to which the security interest arises (that is, in this case the supply agreement containing a retention of title clause) and not in the circumstances under which possession was transferred from one party to another.

Therefore, the court held that JSB had a security interest in the wool supplied to Feltex under the PPSA. However, the failure to register a financing statement in respect of that security interest meant that JSB lost the "super-priority" it would otherwise have been accorded because of its retention of title in the wool, and accordingly, the bank's claim over Feltex's assets took priority.

The court dismissed the claim for conversion as, while JSB itself did not intend to deliver the wool, JSB's agents voluntarily delivered the wool to Feltex and a voluntary transfer of possession from the agent of the supplier to the buyer is a lawful transfer and cannot amount to conversion. There was no fraud or deliberate deception involved on the facts.

Practical implications

Both of these cases serve as reminders that where a supplier has any concerns over payment being made for goods, it is imperative that steps are taken up-front to avoid later disappointment. In particular:

- supply agreements and/or terms of trade should be reviewed to ensure that they include a security interest which is consistent with the PPSA and is appropriate for your supply arrangements;
- as priority between competing security interests is now determined under the PPSA regime, suppliers should ensure that they perfect their security interest by registering a financing statement on the PPSR within the applicable timeframe. Failure to do so could result in your security interest being defeated by perfected security interests in respect of the same goods;
- suppliers must ensure that the information provided in the financing statement is accurate. If a registration is "seriously misleading" because of an error or omission in a financing statement, the supplier's security interest may be rendered unenforceable.

Commercial business law

Doing business in New Zealand: a guide

Bell Gully has updated its guide to doing business in New Zealand with the latest legislative developments. The guide provides up-to-date information to overseas investors and their professional advisers about investing in, and trading with, New Zealand.

The guide provides an overview of issues for the overseas investor to consider, including legislation and regulation covering areas such as immigration, employment, tax and competition (antitrust). It also looks at the requirements for starting a business in New Zealand.

[Click here](#) to view a copy of the guide.

Company law

Health board report has important messages for private sector too

The Director-General of Health established a Review Panel in July last year to consider issues relating to conflicts of interest that may have arisen at Hawke's Bay District Health Board (DHB). The panel released its report to the Director-General on 14 March 2008. While DHBs operate under a statutory framework that includes specific regulation of key governance issues, including the duties of Board members and disclosure obligations, there are strong parallels with the role of Board members in both the public and private sector. In this article, senior associate Stephen Layburn reviews the Hawke's Bay DHB report and considers its implications for governance in the corporate sector.

Debate continues on the legal consequences of amalgamations under Part 15

In the Summer 2008 issue of *Commercial Quarterly* we noted the Court of Appeal's decision in *Elders New Zealand Limited v PGG Wrightson Limited* dealing with the legal consequences on third party contracts of court ordered amalgamations under Part 15 of the Companies Act. However the Court of Appeal's decision may not be the final word on this topic.

Company law

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The Director-General of Health established a Review Panel in July last year to consider issues relating to conflicts of interest that may have arisen at Hawke's Bay District Health Board (DHB). The panel released its report to the Director-General on 14 March 2008. While DHBs operate under a statutory framework that includes specific regulation of key governance issues, including the duties of Board members and disclosure obligations, there are strong parallels with the role of Board members in both the public and private sector. In this article, senior associate Stephen Layburn reviews the Hawke's Bay DHB report and considers its implications for governance in the corporate sector.

Key Hawke's Bay findings

To recap, an independent panel was appointed by the Director-General of Health to review the Hawke's Bay District Health Board's (HBDHB) handling of conflicts of interest after concerns were raised about tender processes for community healthcare and a pilot training programme. Among the panel's findings were inadequacies of disclosure by a Board member of his involvement, prior to appointment to the Board, in the development of an RFP for a tender in which his company was a bidder and concerns about the adequacy of the management of the interest of another Board member in relation to the Board's review of its community pharmacy funding activities.

The panel found HBDHB and Board members did not adequately handle conflicts of interest even though the Board actively encouraged disclosures by its members. In handling any conflicts, the panel noted that disclosure itself is not enough - in most cases (in the absence of a statutory waiver) the conflicted Board member should not participate in Board deliberations on the relevant matter.

The panel also commented that there were direct communications between Board members and management on operational matters and that this was generally not appropriate or consistent with good practice. These issues may have been compounded by the Board's governance manual failing to address conflicts of interest in a comprehensive manner as well as having minimal induction and training for Board members, the panel said.

Conflicts of interest in the private sector

Companies operating in the private sector are also subject to detailed compliance obligations regarding the disclosure and management of conflicts of interest. The Companies Act 1993 requires that:

- all companies must maintain an interests register;
- individual directors must make disclosure of transactions in which they are "interested" (as that term is defined in the Companies Act) and ensure that those disclosures are entered in the interests register. Where there is more than one director, those disclosures must be made to the Board; and
- the details of disclosures entered in the interests register must be published in the annual report and made available for inspection.

The Companies Act also contains detailed provisions governing the circumstances in which a company can avoid a transaction in which a director is "interested" and also provides that an interested director may attend and vote at a Board meeting of directors at which a matter relating to a transaction in which he or she is interested arises - unless the constitution provides otherwise.

For listed companies, in addition to the detailed protections built around the concept of Related Party Transactions, the NZX Listing Rules add a further layer of obligations by:

- requiring listed issuers to have a minimum of two "Independent Directors". They must not be executive officers of the company and have no "Disqualifying Relationships";
- reversing the default setting contained in the Companies Act by providing that interested directors shall not vote on matters in which they are interested; and

- requiring benchmarking of corporate governance principles against the NZX's Corporate Governance Best Practice Code, which includes a specific recommendation that listed issuers formulate a code of ethics including standards and procedures for the handling of conflicts of interest.

Across the public divide

In the Hawke's Bay case are key points of direct relevance in the corporate sector around maintaining an interests register and disclosure. These cover the timing and content of disclosures, the range of circumstances in which a conflict should be disclosed and the need for vigilance on the part of a Board in determining the extent of a conflict or potential conflict. There is also mention of the need to consider each disclosure and (where appropriate) make further enquiry to determine the full extent of the conflict and its impact on Board activities.

The nature and size of New Zealand business means that, even in the listed company arena, the likelihood of conflicts of interest arising out of routine transactions are such that the management tools discussed by the panel are equally relevant in the private sector. In particular, there is a very real risk that the specialist expertise that even the most experienced director brings to the Board table may ultimately be outweighed by the need for the company to obtain comfort that transactions are undertaken on arms length terms and for it to be seen to have arrived at decisions independently. These discussions are much more clear-cut in a listed company environment, when the NZX Listing Rules require interested directors to disclose and abstain.

Lessons derived from the panel's report are worthy of further examination by most companies in which the Board represents the interests of a wider group of stakeholders than just owner/operators, including:

- the need for training for directors about the extent of their obligations to address conflicts of interest;
- the benefits from ensuring that there are adequately documented procedures in places for dealing with conflicts – in a governance manual or similar document; and
- the wider governance issues that arise out of situations of conflicts of interest, including the management issues that flow from a conflict of interest such as the need to carefully consider direct contact between the affected Board member and the company's management team.

What lies ahead

After the smoke clears from the ensuing debate between those involved as to the ultimate responsibility for many of the Hawke's Bay Board's difficulties, the key messages from the panel's report may become clearer.

At the core is that the overlay between legal duties, ethical considerations and best practice is such that a Board must ensure that it lays down an adequate framework and continues to monitor its functions against appropriate standards and procedures for sound corporate governance.

Perhaps the likelihood of a difficult trading environment for a range of sectors of the economy only serve to remind us that the proper functioning of a Board is more likely to leave it better positioned to work well with management to address the challenges that lie ahead.

* For more details about the Hawke's Bay report and its key implications for DHBs and other Crown Entities [click here](#).

Company law

Debate continues on the legal consequences of amalgamations under Part 15

*In the Summer 2008 issue of Commercial Quarterly we noted the Court of Appeal's decision in **Elders New Zealand Limited v PGG Wrightson Limited** dealing with the legal consequences on third party contracts of court ordered amalgamations under Part 15 of the Companies Act. However the Court of Appeal's decision may not be the final word on this topic.*

In *Elders New Zealand Ltd v PGG Wrightson Ltd*³, the Court of Appeal upheld the High Court's earlier decision that court ordered amalgamations under Part 15 of the Companies Act 1993 (the Act) could result in the same legal consequences as amalgamations under Part 13 of the Act – namely that the amalgamated company stands "in the shoes of the amalgamating companies" and therefore receives the benefits of, and incurs the obligations pertaining to, all assets and liabilities of the amalgamating companies. For further details on this decision refer to our earlier article [Amalgamations and their effect on existing contractual relations](#).

However, on 18 April the Supreme Court⁴ granted leave to appeal the court's decision on the following grounds:

- (1) Whether an amalgamation approved under part 15 of the Act has the same effect as an amalgamation under Part 13;
- (2) Whether the final order made by the High Court under Part 15 had the legal consequence that Pyne Gould Guinness Ltd and Wrightson Ltd continue as one company, namely PGG Wrightson Ltd.

The hearing date has been set down for 12 August 2008. We will keep you informed of further developments.

³ [2007] NZCA 596

⁴ [2008] NZSC 30

Securities and capital markets

Interim report on the Financial Advisers Bill

The Finance and Expenditure Committee has considered the Financial Advisers Bill, particularly the definition of "financial adviser" and the institutional arrangements for supervising them, and has released its interim report.

Law change makes it easier for local authorities to re-enter the public debt-securities market

A recent amendment to the Securities Act 1978 will simplify the disclosure requirements and make it easier for local authorities to issue debt securities to the public. In this article, partner Glenn Joblin outlines the scope of the amendment.

Securities Commission completes Cycle 6 of its Financial Reporting Surveillance Programme

In Cycle 6 of the Securities Commission's Financial Reporting Surveillance Programme, the commission reviewed the financial reporting practices of 30 issuers with balance dates from 31 December 2006 to 30 April 2007. Twenty of the 30 annual reports reviewed had matters that prompted the commission to write to the respective issuers.

Securities and capital markets

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The Financial Advisers Bill (the bill) seeks to establish a co-regulatory regime for financial advisers, with the Securities Commission and approved professional bodies working together to create and monitor standards for financial advisers.

Proposed change to definition of "financial adviser"

There has been some opposition to the proposed definition of "financial adviser" in the bill, based mainly on concerns that the definition is too wide and might unintentionally catch businesses that advise infrequently, or as an ancillary service only.

In response to the opposition, the committee has reported its intention to invite submissions on a revised definition of "financial adviser". The revised definition is intended to be narrower in scope, catching only those whose primary business is providing financial advice, and those who do so regularly in their ordinary course of business.

Proposed change to regulatory model

The committee has also expressed its intention to invite submissions on a change to the proposed regulatory model, so that the Securities Commission undertakes the functions and powers of the new regime rather than industry-led approved professional bodies.

For a copy of the Finance and Expenditure Committee's interim report on the Financial Advisers Bill, go to www.parliament.nz

Securities and capital markets

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A recent amendment to the Securities Act 1978 will simplify the disclosure requirements and make it easier for local authorities to issue debt securities to the public. In this article, partner Glenn Joblin outlines the scope of the amendment.

Introduction

The Securities (Local Authority Exemption) Amendment Act 2008 provides local authorities with an exemption from the full disclosure requirements of that Act when issuing debt securities to the public. Local authorities will be required to issue an investment statement, but not a registered prospectus, when issuing debt securities to the public.

The exemption will mean that local authorities will be subject to the same disclosure requirements that apply to similar existing exemptions for the Crown, the National Provident Fund Board, the Reserve Bank and Housing New Zealand Corporation.

Purpose of amendment

A similar exemption for local authorities was repealed in 1996 (with effect from 1998). As a result, local authorities were subject to the same disclosure obligations as companies and other corporate entities in relation to a public issue of debt securities.

The lack of debt issues by local authorities over the past 10 years indicates that the disclosure obligations under the Securities Act were a barrier to issuing debt securities, particularly for smaller local authorities. Local authorities were already required to produce detailed information on their activities and plans under the Local Government Act and they saw disclosure requirements for a prospectus as creating a substantial degree of duplication and unnecessarily imposing additional compliance costs.

In addition, it was necessary to have all councillors of a local authority sign a prospectus in order to comply with the Securities Act 1978. This meant that a single dissenting councillor could prevent an issue of debt securities by refusing to sign the prospectus. The same issue does not apply to an investment statement as it is not required to be signed by directors of the issuer.

The relaxation of the disclosure requirements applicable to local authorities comes at a time when they are facing additional demands for infrastructure funding. The Government has stated that local authority long-term plans show that local authorities are undertaking some \$30.8 billion in capital works (network or community infrastructure) over the next 10 years, and 50 per cent of this amount could be required by 2009. The Securities (Local Authority Exemption) Amendment Act is intended to assist local authorities to fund these works.

Scope of exemption

Local authorities will no longer be required to issue a registered prospectus of an issue of debt securities. This will significantly simplify the disclosure requirements for local authorities wishing to issue debt securities to the public and while they will still need to issue an investment statement and appoint a trustee to act on behalf of security holders, an investment statement can be a relatively brief document.

The investment statement relating to the debt securities must refer to the most recent audited financial statements, and audited consolidated financial statements, for the local authority. Those financial statements will be treated as forming part of the investment statements but there is no need to include any specific financial information in an investment statement.

A local authority which issues debt securities will be borrowing under the Local Government Act. This allows local authorities to charge a rate or rate revenue as security for the issue of debt securities.

It will be interesting to see to what extent local authorities now access the public debt securities market to fund capital projects. The recent successful \$200 million perpetual preference share issue by

The Bay of Plenty Regional Council, through its subsidiary company Quayside Holdings, indicates that there is likely to be strong demand for debt securities issued by local authorities.

Securities and capital markets

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Numerically there was a higher incidence of *matters raised* in Cycle 6 compared with previous cycles. However, on reviewing the findings, the Securities Commission notes that it "does not believe that this higher incidence is symptomatic of poorer accounting given the nature of the findings. Generally, issuers' compliance with NZ GAAP is good and the commission continues to be encouraged by the commitment of issuers and their auditors to comply with NZ GAAP and to provide a true and fair view of the state of affairs of those issuers." The matters raised with issuers in Cycle 6 included:

- (a) matters relating to NZ IFRS financial statements;
- (b) matters relating to previous NZ GAAP financial statements; and
- (c) market matters.

The market matters concerned failure to comply with substantial security holder obligations, not disclosing director share dealings and a failure by one issuer to disclose material information, relating to a restriction on the timing of any future acquisition of a business, in its annual report in accordance with the NZX Listing Rules.

In its report the Securities Commission made special mention of the new Securities Markets Act provisions relating to substantial security holder disclosures which came into force on 29 February and in particular noted that in future, failure to comply with substantial security holder obligations will be a criminal offence, subject to a fine of up to \$30,000. Civil penalties of up to \$1 million can be imposed by the court, which can also make a range of orders relating to any holding of securities, including orders to forfeit or dispose of securities.

See [news release](#) and [report](#).

Competition and consumer law

Price control amendments: more or less control?

A rewrite of New Zealand's price control laws has hit the halls of Parliament. The Commerce Amendment Bill, introduced to the House on 13 March, is the culmination of an 18-month review and consultation process and is described by Commerce Minister Lianne Dalziel as "a back-to-basics rewrite" of the country's price control provisions drawing on "best-practice regulation in other OECD countries". In this article, senior associate David Blacktop comments on the key aspects of the bill and considers whether its objectives are likely to be met in practice.

Customer discounts: surely always a good thing?

The answer to that question is "yes...most of the time" says senior associate Torrin Crowther in this article on the competition issues surrounding straight and bundled discounts to customers.

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Bell Gully has authored the New Zealand chapter in a publication which looks at antitrust laws and regulations in the pharmaceutical industry across 29 jurisdictions worldwide.

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Price control is designed to ensure that there is efficient and cost-effective regulation of the price and quality of goods or services which are not subject to competition. Until the last decade, the post-1984 era has seen very few goods and services placed under price control in New Zealand. This trend has reversed in the last decade as telecommunications, electricity lines businesses and gas pipelines fell under price control. The experience in these sectors has perhaps guided the government to reassess the price control provisions and led to the following key changes.

New purpose statement

The bill introduces a specific price control purpose statement. The objective is to maximise the long term interests of consumers by mimicking as far as practicable the outcomes of competitive markets. This does not just mean lower prices today or tomorrow; the bill recognises the importance of providing correct price signals for investment, research and development and efficiency, in order to promote sustainably lower prices.

New Zealand welfare approach to regulation

Under the bill the Minister can only recommend regulation if the benefits of regulating *clearly* exceed its costs and risks. The bill also requires the Commerce Commission to examine the impact of regulation on market efficiency, distributional and welfare consequences, in both qualitative and quantitative terms where "possible and practicable". In economic terms, this reflects more of a "total welfare" approach to regulation – i.e. regulation is justified if it is in the interests of New Zealand as a whole – as opposed to the commission's current approach where regulation is mandated if consumers as a group are better off overall. These changes reinforce the idea that regulation is a back-stop mechanism not to be invoked lightly and only where it is demonstrably good for New Zealand rather than particular groups.

More options for "control"

The current regime provides for bright line regulation. This means there is either full price control or there is none. There is no middle ground. Given the costs of control this places a high bar before price control can be imposed.

The bill provides the commission with a greater armoury to exert "control". It will be able to recommend companies be placed under a range of forms of regulation namely:

- An information disclosure regime under which companies must disclose certain information, such as prices, to the commission which in turn performs a monitoring role. The rationale being that businesses will temper any supra-competitive pricing for fear of further regulation. The bill immediately imposes this regime on Auckland, Christchurch and Wellington international airports.
- A negotiate/arbitrate regime under which a company will be required to reach agreement, through negotiation, on the supplier's prices and quality standards during a specified regulatory period, and to provide for binding arbitration if negotiation is unsuccessful. This regime is similar in concept to the Telecommunications Act 2001.
- A default/customised price-quality regime, similar to the existing Electricity Lines Business (ELB) price path threshold regime but with major improvements (outlined below).

Whether these changes mean more businesses will fall under price control remains to be seen. However, they do appear to lower the costs of some form of control, making it more likely that any cost/benefit

analysis would favour regulation. The requirement that benefits of regulation clearly exceed the costs should provide a check and balance in the system to prevent over-regulation.

Electricity regulation: fitting the punishment to the crime

The bill reforms the current price path regime for ELBs, which now provides that ELBs can only increase prices by the CPI-X each year. If an ELB breaches the threshold, the commission can impose control regardless of the size of the breach. To illustrate, Vector's entire lines business was controlled after it breached the thresholds by less than \$80,000. Arguably, the punishment did not fit the breach. In fact, arguably it was not aimed at the actual breach at all but rather provided a window to require Vector to "re-balance" its prices and the returns from each customer segment it supplied.

The bill also removes the commission's ability to simply impose control for breach. The commission will now have to apply for a court order that a company in breach pay a fine of up to NZ\$5m, and pay compensation to affected persons suffering loss. The commission will also be able to seek an injunction restraining a business from supplying goods or services in contravention of a price path threshold, or positively requiring them to do so.

More certainty for Electricity Lines Business

The default/customised price-quality regime has evolved from the current ELB price regime. Critics have argued this regime provides little incentive and certainty for investment. This is because an ELB making an investment and wishing to earn a return on that investment will almost invariably increase prices and thereby breach its CPI-X threshold.

In effect this gives the commission an *ex-post* investment approval role. The ELB in breach must satisfy the commission the investment was warranted so it is not subject to price control. This creates obvious uncertainty because an ELB does not know *ex-ante* whether it will be able to earn a return on an investment. The issue was famously highlighted when Vector put a hold on all new investment after the commission published its intention to declare control.

Under the new regime, ELBs will be able to apply for a customised price path where, for example, major investments are needed. This enables ELBs to ascertain *ex-ante* what return they will receive on an investment. Combined with the new penalty provisions this should materially alter the risk profile for new investment.

Allied to this is the new requirement for the commission to publish binding input methodologies setting out its method for determining the cost of capital, valuing assets, allocating common costs, etc. These will be set and applied equally and consistently to provide more certainty and timeliness to the customised path process.

While these changes are generally very positive, with the commission's burgeoning responsibilities, it could be that resource constraints limit their practical effectiveness. For example, the bill limits the number of customised paths the commission needs to consider each year to four. If an ELB is not "in early" it may end up with the default path for an additional 2-3 years thereby delaying necessary investment or forcing ELBs to risk a breach.

This article was first published in NZLawyer, 4 April 2008.

Competition and consumer law

Customer discounts: surely always a good thing?

The answer to that question is "yes...most of the time" says senior associate Torrin Crowther in this article on the competition issues surrounding straight and bundled discounts to customers.

Offering customers discounts and rebates is standard practice in many industries, and as a general rule *straight* discounts – where customers receive a discount to reflect the efficiencies associated with increasing volumes – do not raise competition law issues.

However, *bundled discounts* – where discounts are available if a customer buys a number of *different* products (or a certain volume of different products) from the same supplier – can give rise to competition law issues, depending on their structure. In many cases bundled discounts simply reflect efficiencies in the form of reduced transaction costs, etc. and are a function of competition at work. However, in some cases they can be anticompetitive, often where they are used to leverage market power in one market into another more competitive market, or artificially raise entry barriers and impact the competitive process in a real way.

Identifying when bundled discounts are anticompetitive has exercised the minds of competition regulators, lawyers, academics and economists for some time. In fact, US regulators recently argued to the US Supreme Court that it should *refuse* to grant leave for a particular appeal because the current thinking on bundled discounts was insufficiently developed, with the result that the court "would be well served to await further development of the case law, and further insights from academic commentary". All of which is cold comfort for practitioners asked to advise on the legality of bundled discounts *today*.

In Commerce Act terms, the issue is whether the bundled discount amounts to: (i) a taking advantage of a substantial degree of market power for a prohibited purpose; or (ii) an agreement having the purpose, effect or likely effect of substantially lessening competition. A relatively recent Commerce Commission report on a Telecom discount structure provides an insight into the approach the commission may take.

In early 2004, Telecom introduced a bundled discount whereby customers received a \$10 per month discount on broadband internet access if they also used Telecom for local calling and toll calls. Broadband competitors claimed their margins were being squeezed with the result they could not compete in the face of the \$10 discount.

The commission considered a number of different tests to assess whether the bundled discount breached the Act, noting that the appropriate test will depend on the circumstances. In the case of Telecom, it concluded the "competitive bundle test" was the most appropriate. This test involves applying the overall discount (in Telecom's case, \$10) to the price of only those products within the bundle *for which the firm faced direct competition* (in Telecom's case, toll calls and broadband internet access) in order to test whether efficient competitors offering the same bundle could earn positive margins. If the average margin was negative, such that equally efficient firms could not replicate Telecom's offer, then the commission's view was that the 'take advantage' limb of a misuse of market power would be satisfied. This in turn would give rise to a breach of section 36 of the Act if the 'substantial market power' and 'prohibited purpose' limbs were also satisfied. The commission concluded that on the facts there was unlikely to have been a 'taking advantage' and hence there was no such breach.

On whether the discounts substantially lessened competition in a market in breach of section 27 of the Act, the commission said its analysis did not reveal any exclusionary purpose or anticompetitive effect sufficient to substantially lessen competition in any market. In reaching that view, the commission took comfort from the fact an equally efficient competitor in the provision of broadband access and toll call services could compete with Telecom, despite the discount.

While the commission's analysis provides some helpful guidance, it is important to recognise that the competitive bundle test – like all the various tests advanced on the issue – has been criticised by commentators as not always appropriate. It is certainly not the case that a discount that fails the competitive bundle test will *necessarily* give rise to an issue, although it would certainly justify careful consideration. Unfortunately, the flip side is that a discount structure that satisfied the competitive bundle test *could*, depending on the circumstances, in theory give rise to a breach.

Ultimately, the issue is whether the conduct breaches the plain wording of the Commerce Act. While the competitive bundle test is a useful tool to employ, consideration of the following factors will also help to focus the issue.

- Does the competition offer similar bundled discounts?
- Will the discount structure "lock up" sufficient customers such that competition as a process is likely to suffer?
- What is the rationale for the discount structure? Can it be justified on the basis of volume/efficiencies?
- (Where the firm has substantial market power) would a firm without substantial market power but otherwise in the same circumstances implement such a discount structure?

This article was first published in NZLawyer, 2 May 2008.

Competition and consumer law

Pharmaceutical regulatory law in New Zealand

Bell Gully has authored the New Zealand chapter in a publication which looks at antitrust laws and regulations in the pharmaceutical industry across 29 jurisdictions worldwide.

In 2008 the Global Competition Review published the first edition of *Getting the Deal Through - Pharmaceutical Antitrust*. Partner Phil Taylor and senior associate Torrin Crowther contribute a chapter on pharmaceutical regulatory law in New Zealand and examine how the law is enforced.

They review how mergers between pharmaceutical companies are controlled, what constitutes anti-competitive conduct and how authorities manage such conduct, along with legal trends and developments in the pharmaceutical area.

[Click here](#) to read the New Zealand chapter, reproduced with permission from Law Business Research.

This article was first published in *Getting the Deal Through – Pharmaceutical Antitrust 2008*, (published in April 2008 - contributing editor: Marleen Van Kerckhove). For further information please visit www.GettingTheDealThrough.com

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Competition and consumer law

Searches by the Commerce Commission

Bell Gully has produced a guide outlining the steps a business can take to ensure searches by the Commerce Commission are carried out appropriately.

The guide describes what immediate action should be taken, what to do during the search, recommended follow-up action and some general points to consider about the search.

[Click here to read this guide.](#)

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Intellectual property and information technology

New copyright law for the 21st Century

After years of debate and consultation over how New Zealand's copyright legal framework should be amended to fit in with technologies in today's digital environment, the Copyright (New Technologies) Amendment Bill has been passed. In this article, solicitor Jessie Parker takes a practical look at some of the key provisions.

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In this article, senior associate Heidi Leslie comments on a case in which a major US company is suing software developer SAP claiming a "complete failure" of a multi-million dollar system and notes how this case brings some timely reminders on technology contracts for New Zealand business.

Protecting information: contracting to account for the Official Information Act

Have you ever thought about how your trade secrets could end up being released as part of an Official Information Act (OIA) request? In this article, senior associate Heidi Leslie alerts us to potential issues that may arise when dealing with organisations subject to the OIA and outlines some contractual protections that can be put in place to avoid information inadvertently becoming part of the public domain.

Unpacking privacy issues: the all knowing search engine

In this article, senior associate Heidi Leslie and law clerk Nick Laing take a look at the very topical issue of privacy and service providers on the internet in light of the European Union's recently released report which offers an opinion on the collection of personal data by search engines.

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The Copyright (New Technologies) Amendment Bill passed its third reading on 8 April 2008. The purpose of the bill is to update the Copyright Act 1994 to make it "technology neutral" – meaning that copyright can be consistently applied regardless of the medium involved. This bill follows similar legislation in other western countries.

When the bill comes into force, the Copyright Act will have an expanded meaning of the term "copy". The definition of "copying" will include the reproduction, recording and storage of works in digital format. This amendment captures unintentional copying through internet use. However, transient or incidental copying will not infringe copyright if it is an integral and essential part of a technological process and has no independent economic significance.

Also, the terms "communicate" and "communication work" will replace references to broadcast and cable programs. The new terms are broadly defined - communicate means "to transmit or make available by means of a communication technology" and communication work means "the transmission of sounds, visual images or other information for reception by members of the public".

Some of the changes to copyright law in New Zealand that will have a practical impact are set out below.

<p><i>What is an ISP's liability for copyright infringement? For example, what happens if it notices a user downloading free music from a Russian website?</i></p>	<p>ISP liability for copyright infringement is arguably increased under the new regime. The bill requires every ISP to have a policy that provides for termination of a user's account where that user repeatedly infringes the copyright in a work using the ISP's services. With such a policy in place, the bill provides that no ISP will be liable merely because a person uses the ISP's services to infringe copyright.</p> <p>An ISP will also not be liable for storing material that infringes copyright unless the ISP knows or has reason to believe the material infringes copyright and does not delete the material after becoming aware of the infringement.</p> <p>The difference between storage and caching is recognised and provided for in the bill. Caching is the short-term storage of data. It enables ISPs to transmit material more efficiently by temporarily placing data, or a copy of it, in a location where it can be accessed faster than normal. The bill provides that an ISP does not infringe copyright in a work by caching if it:</p> <ul style="list-style-type: none">• does not modify the material;• complies with any conditions of the copyright owner;• does not interfere with the lawful use of technology to obtain data on the use of the material; and• updates the material in accordance with reasonable industry practice. <p>However, an ISP will infringe copyright in material if it does not delete or prevent access to it by users as soon as possible after becoming aware that the material has been deleted or blocked at its original source.</p>
<p><i>Can schools use website material for teaching?</i></p>	<p>Educational establishments are permitted to store a copy of a work that is available on a website if the material is stored for an educational purpose and it:</p> <ul style="list-style-type: none">• is displayed under a separate frame or identifier;• identifies the author (if known) and source of the work;

	<ul style="list-style-type: none"> states the name of the educational establishment and the date on which the work was stored; and is restricted to use by participants in the course of instruction.
<i>Is it legal to copy music onto an i-pod?</i>	<p>Sound recordings may be copied into other formats for personal use. However, this does not apply to other audiovisual media such as videos. This widespread practice of copying sound recordings into digital formats (for example, for i-pods and mp3 players etc) will not infringe copyright if:</p> <ul style="list-style-type: none"> the copy is made from a legitimate sound recording; the sound recording is not borrowed or hired; the copy is for the private and domestic use of the owner or members of their household; only one copy is made for each device that the owner uses for playback; and the owner of the sound recording retains ownership of the original and any copies made. <p>The rule does not apply to copying that is inconsistent with a contract that specifies the circumstances in which the sound recording may be copied. Activities such as CD copying or online file sharing will continue to be an infringement of copyright.</p>
<i>Most computer program licences do not permit decompiling or reverse engineering. Is this permitted under the bill?</i>	<p>Users of computer programs expressed in low level language may now decompile the computer program:</p> <ul style="list-style-type: none"> where the decompilation is necessary for creating another independent program and the program is only being decompiled for that purpose and is not substantially similar to the decompiled program; where it is necessary for the lawful use of the program, for example to correct an error in the program, and a properly-functioning and error-free copy of the program is not available within a reasonable timeframe at the ordinary commercial price; and for the observation, studying or testing of a computer program, provided it is done in order to determine the principles and ideas that underlie any element of the program. <p>Certain contractual terms are deemed to be of no effect if they prohibit or restrict the study, observation or testing of a program in order to determine its underlying principles.</p>
<i>Is it permitted to unlock DVDs that have locks on them to prevent copying?</i>	<p>Technological Protection Measures (TPMs) are measures designed to counteract copyright infringement activities. The most commonly recognised TPMs are those built on to music CDs and DVDs that prevent copying by what the bill describes as "circumvention devices", more commonly known as TPM spoilers.</p> <p>The sale or hire of these circumvention devices is made illegal as well as the actions that lead to the potential sale or hire of them such as making or importing them. The bill creates an offence for those who enable or assist others to circumvent TPMs.</p> <p>The actual circumvention of a TPM device is not prohibited. Exceptions are provided for to allow certain categories of people, including librarians or archivists, to circumvent TPMs in order to copy the work for their legitimate purpose.</p>

The majority of the provisions of the Copyright (New Technologies) Amendment Act are expected to come into force in October 2008 (by Order in Council) following the implementation of two sets of regulations

which must be made in relation to prescribed forms for ISPs and TPMs. However, section 19(2) of the Amendment Act, which extends the parallel importing ban on films until 31 October 2013, came into force on 12 April 2008.

To access a copy of the Amendment Act and for further details visit the Ministry of Economic Development's website at www.med.govt.nz

Intellectual property and information technology

US technology case brings reminder for New Zealand business

In this article, senior associate Heidi Leslie comments on a case in which a major US company is suing software developer SAP claiming a "complete failure" of a multi-million dollar system and notes how this case brings some timely reminders on technology contracts for New Zealand business.

Waste Management, Inc is suing SAP Americas Inc and its German parent for losses and punitive damages over a US\$100 million enterprise resource planning (ERP) system that it claims has turned out to be "undeveloped, untested and defective".

The SAP system was supposed to help Waste Management, Inc, the US's largest rubbish company, manage tasks unique to its industry (such as waste disposal, recycling and logistics) without customisation and therefore save Waste Management, Inc money. However, the claims are that the SAP system was not designed for the US market, was untested in that market and, allegedly, did not work in that market.

While much of the detail of the law suit are yet to unfold and the degree to which they will be disclosed may depend on any agreement reached, there are some considerations that arise for New Zealand companies investing in ERP solutions.

In this country a typical agreement for an ERP solution will often include a clause that would be key to this law suit - providing that SAP is not liable for the loss of Waste Management, Inc's anticipated savings. However, a clause like this is not standard. When parties negotiate exclusions of liability, they should be aware of their particular needs from the agreement.

In this case, Waste Management, Inc reportedly had great expectations of cost savings in its business from the ERP. If cost saving is one of the primary purposes for entering into an agreement, the customer should not agree, without a good deal of forethought, to exclude anticipated savings as a category of loss. Quite the opposite. The customer should push to ensure that any of these losses are clearly included as "direct" losses that the customer might suffer as a result of the product or the acts or omissions of the ICT company.

The same holds true for other categories of loss that ICT companies may seek to exclude from their liability, such as software restoration costs, downtime and loss of, or damage to, data. If a customer is engaging an ICT company for the purposes of data protection and storage, for example, it is not clear why that customer would agree to exclude loss of data as a category of loss under the agreement.

The message here is that there is no fixed approach to liability clauses. No matter how "boilerplate" a clause appears to be, a customer needs to focus on what is important to it before signing the contract. The purposes of entering into the agreement should be kept in mind when negotiating every part of the agreement, including the liability provisions.

The time spent getting it right upfront could again save the pain down the track should anything end up not going to plan.

Excerpts from this article were first published in the Dominion Post, 14 April 2008.

Intellectual property and information technology

Protecting information: contracting to account for the Official Information Act

Have you ever thought about how your trade secrets could end up being released as part of an Official Information Act (OIA) request? In this article, senior associate Heidi Leslie alerts us to potential issues that may arise when dealing with organisations subject to the OIA and outlines some contractual protections that can be put in place to avoid information inadvertently becoming part of the public domain.

It is now commonplace for companies to enter into non-disclosure or confidentiality agreements before they share confidential information with other organisations. It is a good precaution to take, in particular if companies also clearly mark their confidential documents as "confidential" leaving no doubt as to whether the obligations of confidentiality apply to them.

Putting in place the protections needed upfront are among the issues to be considered by the chief information officer when dealing with outsourcing contracts or projects, especially when valuable intellectual property or trade secrets are involved.

When contracting with organisations subject to the Official Information Act (OIA) [1], entities should also consider addressing the OIA directly in their non-disclosure, confidentiality and other commercial agreements. This applies even where both contracting parties are subject to the OIA as each party will have its own reasons for wanting to protect information from unwanted disclosure.

An organisation which is subject to the OIA is compelled to release information upon receiving a valid OIA request, unless there is "good reason" not to. The "good reasons" are prescribed by the OIA and are quite narrow.

When it comes to the release of commercially sensitive information, the two main good reasons for withholding the information are that it is a trade secret or its release is likely "unreasonably" to prejudice the commercial position of the person who supplied the information. Even then, the information must be disclosed if the "public interest" for disclosure outweighs the reasons to not disclose.

Because of this, it is up to the party providing the information to the OIA organisation to ensure it has a say in what information is a trade secret or would unreasonably prejudice it if it were to be released. If there is no contractual framework around how information may be released, the OIA organisation has no obligation to consult with the party providing the information before it is released to the public under an OIA information request.

[1] The OIA has sweeping application, the extent of which is not always appreciated. It applies, for example, to all State-Owned Enterprises (SOEs) as well as educational institutions and government organisations.

Ascertaining whether the party you are sharing information with is subject to the OIA is, in itself, a bit of a daunting task. The Directory of Official Information July 1999 is posted on the Ministry of Justice website. It is theoretically an alphabetised list of all organisations to which the OIA applies.

However, the directory is out of date and potentially misleading. Here are a few examples:

- organisations that go by more than one name are only listed under one of those names (Te Mangai Paho is listed under Te Reo Whakapuaki Irirangi (Te Mangai Paho)).
- new organisations have been added since the directory was printed and therefore appear on a separate list. In order to find "Mighty River Power" you would need to look on the "Organisational Changes" list under Mighty River Power's old name – Waikato SOE Limited.
- companies related to State-Owned Enterprises are not listed on their own, even though they, too, are subject to the OIA. So you need to know the parent company name in order to search the directory.

A typical non-disclosure agreement will allow a party to release information if it is required to by law (or worse, will provide that information is not "confidential" if it is required to be disclosed by law). This would mean that an OIA organisation would be permitted to release confidential information when it receives a valid OIA request without first discussing the release with the other party.

As the party supplying the information will be in a much better position to assess whether the information is a trade secret or whether it will unreasonably prejudice it if the information is released, an entity entering into a contract with an OIA organisation should seek to:

- obtain an acknowledgement that the other contracting party is subject to the OIA and may be required to release "confidential information";
- require the contracting party who is subject to the OIA to consult with the party who supplied the information before releasing it; and
- ideally (although this is not often possible), require that if the non-OIA party objects to the release of the information, the information will not be released until the OIA party is definitively required to release it by law – such as following a decision of the Ombudsman.

It is important to note that an OIA organisation is subject to the legislation and it cannot contract out of its obligations. However, including a process that must be followed before information can be released pursuant to the OIA request will put pressure on the OIA organisation to pay heed to its confidentiality obligations - especially if there are consequences for the release of information where the process set out in the contract is not followed.

Thinking about whether a contracting party is subject to the OIA upfront and, if so, accounting for the OIA in contractual documents may well save a lot of grief down the line.

This article was first published by CIO Magazine, March 2008.

Intellectual property and information technology

Unpacking privacy issues: the all knowing search engine

In this article, senior associate Heidi Leslie and law clerk Nick Laing take a look at the very topical issue of privacy and service providers on the internet in light of the European Union's recently released report which offers an opinion on the collection of personal data by search engines.

Picture yourself sitting in front of your PC. You're about to Google your long lost great-great-grandfather. Have you ever stopped to consider what Google does with your query – outside of just finding another genealogical megasite for you?

The truth is, every time you use a search engine like Google, it retains your search history, along with your internet protocol (IP) address. What's more, search engines crawl through the internet compiling information about people – like your long lost great-great-grandfather, making information easier to find, but at the same time creating a "profile" of that person.

Search engines are essential tools for all manner of personal and professional activities, but unbeknownst to many of us they fulfil several roles. They are collectors of information as well as content providers. When you look into it, the amount of information stored by search engines is a bit creepy.

It is undisputed that their first role to the user is as a service provider – being there to find data from websites after the user enters a search command. In the process, they collect vast amounts of data from that user, including IP addresses, search histories using what are known as "cookies", and personalised data that the user submits when subscribing to personalised services such as iGoogle.

Recently, internet provider AOL made the search records of 658,000 of its internet users available over a three month period to researchers. Unfortunately, even though the records had been anonymised, media organisations were able to trace some of the users by name. Needless to say, this was unpopular with the users. A recent survey from the Info-Tech Research Group in London, Ontario, notes that 60% of respondents to a survey are uncomfortable with websites customising content to personal profiles.

Search engines' role as content providers is to bring content to the user. Search engines crawl, analyse and index the web and other sources to make them searchable and more easily accessible. In the process search engines come across personal information about internet users posted on websites, and store that information in a cache. Later republication of this data may pose problems, particularly when a search engine can draw data about a person from many different sources, some of which may be inaccurate or skewed toward certain biases based on popular posts online.

The main concern about the aggregation feature is that it can significantly affect individuals if the personal data in the search results is incorrect, incomplete or excessive. This can lead to the "profiling" of the user by third parties, including incorrect profiling – potentially breaching a person's privacy rights by disclosing that information to the next user who searches their name.

In addition, search engines use search logs. This allows them to monitor and improve the functioning of the services and the user experience. But they also use them to provide targeted advertising. The most recognisable form of this is the Google AdSense programme, which presents advertisements to the right of the search box that relate to the search command entered. More in depth advertising programmes, known as "behavioural targeting", collect significantly more information over an extended period of time, including data on age, sex, geographic location and occupation, to target their advertising at particular demographics. Such advertising allows the use of the search engine to be free. But freedom can come at a cost to personal privacy however, with personal data being collected, stored and used by advertisers without the user's awareness or consent.

The European Union's opinion

In 1995, the European Union (the EU) adopted a directive over the retention of personal "user data" by companies across the EU and the European Economic Area. A report entitled "Opinion on data protection issues related to search engines" released last month (April 2008) offers an opinion on the collection of personal data by search engines.

Looking at the collection and retention of personal data by search engines, the report notes a fundamental imbalance between the reasonable expectations of internet users to privacy on the one hand, and the multiple functions of search engines that are not well understood.

The central issue is the degree of awareness by internet users about these functions. The report says that most internet users are unaware of the large amounts of personal data collected by search engines (including their IP address), and the purposes for which it is being used. Consequently, without such awareness, they are unable to make informed decisions about whether to provide it or not.

The future of online privacy

In the light of the report, search engines in the EU will be likely to refine their procedures for informing users and gaining their consent to use their information, as well as limiting the time that they retain personal data for. They will also be likely to improve their policies for notifying users about the information that they retain and for what purpose it is collected for.

The report will no doubt be read with interest by the New Zealand's Privacy Commission as part of its four stage review of the law of privacy in New Zealand. In its first study paper, published in January this year, the commission began an analysis of the current state of the law, and established the framework for the later stages of its review. How much influence the EU report might have when the commission examines the Privacy Act itself in stage four of the review is eagerly anticipated.

This article was first published in the Dominion Post, 2 May 2008.

Utilities and resources

Passage of the Emissions Trading Scheme is proving to be anything but smooth

In this article, senior associate Kate Radka provides a brief update on the changes to and positions being taken on the Climate Change (Emissions Trading and Renewable Preference) Bill as it nears the end of the Select Committee process.

Challenges to Transpower's North Island grid upgrade continue

The battle is still being fought against Transpower's North Island grid upgrade proposal for the supply of electricity into, and north of, Auckland, both under the Board of Inquiry, which is now underway, and through the courts. In this article, senior associate Louise Hill provides an update on recent events and outlines why one interest group was unsuccessful in the first judicial review application to be heard on an aspect of the grid upgrade.

More guidelines for decision-makers in the electricity sector

A new National Policy Statement on Electricity Transmission, a revised and updated Government Policy Statement on Electricity Governance, and a draft Grid Upgrade Investment Review Policy will provide the Electricity Commission, Transpower and other decision-makers with further guidance on electricity transmission and security of supply issues.

Utilities and resources

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The Finance and Expenditure Select Committee is currently considering the Climate Change (Emissions Trading and Renewable Preference) Bill in light of the numerous written and oral submissions it has received. The committee will also be considering the Government's proposed amendments to the policy underlying the bill, namely:

- the deferral of the introduction of liquid fossil fuels into the scheme from 1 January 2009 to 1 January 2011, in part due to the high fuel costs currently being experienced throughout New Zealand; and
- the deferral of the start of the phasing-out of free allocations from 2013 to 2018. The free allocation of units to agricultural participants and trade-exposed industries is currently proposed under the bill to be phased out gradually over the period 2013 to 2025. Following the Government's announcements it is now expected that such phase-out would be deferred by five years, so that it runs from 2018 to 2030.

The Committee is expected to report back by 11 June, leaving the Government about three months to get the proposed bill through a second and third reading in the House before the general election.

Although National has said that it supports the emissions trading scheme in principle, it has announced that it will not support the bill without:

- all six of its key demands being included in the bill, those being:
 - the need to strike a balance between New Zealand's environmental and economic interests;
 - recognising the importance of small and medium enterprises and not discriminating against them in allocating emission units;
 - being closely aligned with the Australian emissions trading scheme, with common compliance regimes and tradability (which would await the anticipated release of the proposed features of the Australian emissions trading scheme at the end of June 2008);
 - encouraging the use of technologies that improve efficiency and reduce emissions intensity;
 - being fiscally neutral rather than providing billions of dollars in windfall gains to the Government accounts at the expense of businesses and consumers; and
 - incorporating the flexibility to respond to progress in international negotiations;
- sending any re-drafted bill (including a bill that National agrees with) back out for public consultation.

This is not likely to be achieved and therefore National's support will probably not be secured. The Government will need to rely on building a coalition of minor parties in order to secure the passage of its legislation this year.

For more information, please contact [Kate Radka](#) or Bell Gully's Climate Practice Group leader, [Simon Watt](#).

Utilities and resources

Challenges to Transpower's North Island grid upgrade continue

The battle is still being fought against Transpower's North Island grid upgrade proposal for the supply of electricity into, and north of, Auckland, both under the Board of Inquiry, which is now underway, and through the courts. In this article, senior associate Louise Hill provides an update on recent events and outlines why one interest group was unsuccessful in the first judicial review application to be heard on an aspect of the grid upgrade.

Background and summary

In July 2007, the Electricity Commission (the Commission) gave its final approval to Transpower's proposed North Island Grid Upgrade plan for the supply of electricity into, and north of, Auckland (the North Island Grid Upgrade Proposal). This was followed in August 2007 by the Commission's approval of Transpower's separate (but related) proposal for some remedial works to the existing switchyard at Otahuhu and the construction of new gas insulated switchgear at the site (the Otahuhu Proposal).

Both the North Island Grid Upgrade Proposal and the Otahuhu Proposal are "investment proposals" which means that, in accordance with the Electricity Governance Rules 2003 (the Rules), Transpower may recover the costs of the investment from designated transmission customers once the proposals have been approved by the Commission.

As reported in the [Winter 2007 issue of Commercial Quarterly](#), the consultation period leading up to the Commission's approval of both proposals was marked by public protests and controversy over what form these upgrades should take and whether the proposals represent the most appropriate and cost effective option for ensuring security of electricity supply to the upper North Island. As outlined below, the path for the proposals to be approved is still not particularly smooth.

The North Island Grid Upgrade Proposal is currently being considered by the Board of Inquiry, despite a request from one interest group to delay the hearings until its application for judicial review was heard. The hearings are scheduled to last until August 2008.

On another front, the Major Electricity Users' Group (MEUG) applied for judicial review to challenge the decision of the Commission approving the Otahuhu Proposal, but was unsuccessful. In essence MEUG's challenges indicated that MEUG preferred a cheaper, short term option to the Otahuhu Proposal.

Protests continue – Board of Inquiry

The Board of Inquiry hearings into the North Island Grid Upgrade Proposal began on 25 March and are expected to last for a few months due to the number and nature of the submissions received by the Board.

The Minister for the Environment called in Transpower's Notice of Requirements and applications for resource consents relating to the North Island Grid Upgrade Proposal under section 141A of the Resource Management Act 1991 (the RMA) and referred the matter to a Board of Inquiry because the North Island Grid Upgrade Proposal had "aroused widespread public interest regarding effects on the environment" and involves "significant use of natural and physical resources and the proposed transmission line crosses so many councils' boundaries". The call in process effectively combines the councils' consideration and the Environment Court appeal process under the RMA, and means that one body hears Transpower's applications for resource consent, as opposed to the nine affected councils.

An attempt was made on behalf of one interest group, New Era Energy Inc, to adjourn the Board of Inquiry's hearings until the outcome of its judicial review proceedings (filed in December 2007) challenging the lawfulness of the Commission's decision approving the North Island Grid Upgrade Proposal was known. However, following a public consultation on this request, the Board of Inquiry found that the existence of New Era Energy's proceedings did not justify the Board postponing the hearings.

The Board of Inquiry will issue a draft decision after the hearing process ends. Councils, submitters, Transpower and the Minister will then have an opportunity to comment before the Board makes its final decisions. The Board's final decisions can only be appealed to the High Court on points of law.

Judicial Review of the Otahuhu Proposal

Although New Era Energy Inc is still awaiting a hearing on its application for judicial review challenging the Commission's decision in relation to the North Island Grid Upgrade Proposal, a decision on MEUG's application for judicial review of the Commission's decision in relation to the Otahuhu Proposal was handed down by the court in March⁵.

All parties accepted that MEUG had the right to be heard. As Justice Wild stated, MEUG, being the representative of New Zealand's major electricity users, "has a very real interest" in an efficient and quality electricity transmission network. Initially MEUG sued only the Commission. Transpower was joined to the proceedings at its own request.

In general, the grounds for a judicial review of the Commission's decision on any grid upgrade proposal are 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.

MEUG sought judicial review of the Commission's decisions on the Otahuhu Proposal alleging that the Commission had:

- erroneously interpreted clause 4.1 of the Grid Investment Test in the Rules;
- failed to evaluate or require Transpower to evaluate appropriate alternative projects; and
- in approving the Otahuhu Proposal, adopted an erroneous figure for the high impact low probability assumption (HILP) related reliability benefits used in its NPV analysis.

The High Court rejected all three grounds. A brief outline of the Commission's reasoning, MEUG's grounds for review and the court's decision is set out below:

(1) First ground: Erroneous interpretation of Grid Investment Test		
Commission's reasoning	MEUG's reasoning	Court's decision
The Commission must take a long-term view of investment proposals when applying the Grid Investment Test under the Rules, in determining what is necessary to meet the N-1 reliability standard. If the Commission adopted the MEUG analysis, this would lead only to the approval of least initial cost projects and incremental, piecemeal developments.	The Commission erroneously interpreted clause 4.1 of the Grid Investment Test in the Rules. Improvements beyond the minimum necessary to meet the N-1 standard may only be justified on economic grounds – that is, they must maximise expected net market benefits, such benefits being greater than zero. In addition, if a proposal contains work necessary to meet the N-1 standard and work which is beyond the minimum necessary to meet the N-1 standard, this must be disaggregated and treated separately.	The Grid Investment Test does not require the Commission to disaggregate the proposals in the manner contended for by MEUG. It is up to Transpower to formulate the proposals and to submit them to the Commission for approval. MEUG's proposal that only the least initial cost project that meets N-1 should be adopted, by restricting initial investment and therefore cost to the minimum necessary is not consistent with the relevant objectives of the Electricity Act and the Rules: reliability, efficiency and promoting certainty for investment in transmission. The MEUG proposal is also not consistent with the emphasis in the Act, the Rules, and the grid reliability standard, on taking a long term view of developments

⁵ *Major Electricity Users' Group Inc v Electricity Commission* (Unreported Judgment HC Wellington, Wild J CIV - 2007-485-2508 14 March 2008)

		of the national grid and proposals for investments in it.
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(2) Second Ground: Failure to evaluate appropriate alternative projects

Commission's reasoning	MEUG's reasoning	Court's decision
<p>The alternatives to the Otahuhu Proposal considered by the Commission in determining that the Otahuhu Proposal met the requirements of the Grid Investment Test were only two proposals put forward by Transpower. The Commission did not consider other, short term, cheaper options proposed by MEUG.</p>	<p>The Commission failed to evaluate or require Transpower to evaluate appropriate alternative projects. MEUG suggested three alternatives that should have been considered by the Commission against the proposal by Transpower. The only alternative projects considered by the Commission were those presented by Transpower. MEUG submitted that the failure by the Commission to evaluate any short or medium term alternatives was "extremely imprudent", particularly as short term options would give the Commission more optionality as to grid investment planning.</p>	<p>The court accepted that this was an argument on the Commission's decision making process and to succeed MEUG would have to show that the decision of the Commission was unreasonable – one no reasonable electricity commission could have reached.</p> <p>The decision of the Commission was not unreasonable – the Commission took a reasonable approach and considered the options presented to it (which did not include all of the options now presented by MEUG), and rejected the option suggested by MEUG in its submission based on analysis that was the sort of expert assessment which the court stated "the Commission was well placed to make, and the Court ill placed to second guess".</p>

(3) Third ground: Adopted erroneous high impact low probability assumption

Commission's reasoning	MEUG's reasoning	Court's decision
<p>The Commission's assessment of the "high impact low probability" (HILP) assumption was critical to its decision on the Otahuhu Proposal. (A HILP is a very unusual occurrence which has a very substantial impact, for example the events which caused the June 2006 Auckland power outage.) From the Commission's decision it appeared that the Commission found it difficult to assess the value of the HILP, and relied not just on the quantitative data, but also on qualitative factors. Commissioner Pinnell gave a dissenting decision, stating that "Transpower's estimate of HILP-related reliability benefits [are] overstated by more than order of magnitude. I conclude that the difference in reliability between the alternatives and the proposal is immaterial".</p>	<p>In approving the Otahuhu Proposal the Commission adopted an erroneous figure for the HILP related reliability benefits. The Commission made conflicting statements in its decision as to the HILP and the basis for assessment of the value of the HILP. MEUG stated that the information on which the Commission based its HILP assumption was inadequate, and thus the Commission could not be reasonably satisfied that the proposed investment maximised the expected net market benefit or minimised the expected net market cost compared with alternatives and that that conclusion is sufficiently robust having regard to the results of sensitivity analysis.</p>	<p>As with the second ground, the court accepted that this was an argument on the Commission's decision making process and to succeed MEUG would have to show that the decision of the Commission was unreasonable.</p> <p>The Commission needed to select a HILP factor based on its judgement, guided by the available data. In its opinion all the Commission was required to do under the Grid Investment Test was select a HILP factor based on its judgment guided by the available data. Faced with statistical data upon which it could not safely rely, the Commission "adopted a notional probability", albeit one that erred on the side of caution. In the court's view this was not unreasonable in the circumstances.</p>

Reasons for court's rejection of MERG's grounds of review

Erroneous Interpretation of the Grid Investment Test

Under the Grid Investment Test in the Rules, there are two tests to be applied by the Commission in considering whether or not a grid upgrade proposal should be approved, depending on the type of investment:

- for investments that are necessary to meet the N-1 reliability standard (i.e. the grid will continue to operate following one failure), the proposed investment must maximise the expected net market benefit or minimise the expected net market cost compared with a number of alternative projects, and if sensitivity analysis is conducted, a conclusion that a proposed investment satisfies this test is sufficiently robust having regard to the results of that sensitivity analysis;
- for any other proposed investment, the proposed investment maximises the expected net market benefit compared with a number of alternative projects, and the expected net market benefit of the proposed investment is greater than zero, and if sensitivity analysis is conducted, a conclusion that a proposed investment satisfies this first test is sufficiently robust having regard to the results of the sensitivity analysis.

In essence, the difference is that the first test requires the Commission to choose the least cost alternative, while the second test requires the Commission to choose the least cost alternative which also has a positive net market benefit – that is, unless an investment is required to meet the N-1 reliability standard, it will only be approved if the investment has a positive net market benefit.

In its initial submissions to the Commission MEUG had submitted that improvements beyond the **minimum** necessary to meet the N-1 safety net may only be justified on economic grounds – that is, such investments must maximise expected net market benefits, such benefits being greater than zero. The Commission did not agree with this interpretation. The Commission considered that such an approach would lead only to the approval of least initial cost projects, and incremental, piecemeal developments. The Commission stated that MEUG's interpretation does not reflect that the Grid Investment Test requires a long-term view of investment proposals.

MEUG accepted that some of the work outlined in the Otahuhu Proposal was necessary to meet the N-1 reliability standard, and this should be considered separately from work which is beyond the minimum necessary to meet the N-1 reliability standard.

Justice Wild rejected this ground of review, stating that the Grid Investment Test does not require the Commission to disaggregate the proposals in the manner contended for by MEUG. It is inappropriate for the Commission to do so. It is up to Transpower to formulate the proposals and to submit them to the Commission for approval.

Justice Wild also stated that MEUG's proposal that only the least initial cost project that meets N-1 should be adopted, by restricting initial investment and therefore cost to the minimum necessary, is not consistent with the relevant objectives of the Electricity Act 1992 (the Act) and the Rules: reliability, efficiency and promoting certainty for investment in transmission. The MEUG proposal is also not consistent with the emphasis in the Act, the Rules, and grid reliability standard, on taking a long term view of developments of the national grid and proposals for investments in it.

The court stated that the Grid Investment Test requires the Commission to make assumptions about the development path that would be followed over the (minimum 20 year) analysis period if the particular investment proposed by Transpower is constructed. Thus, the expected net market cost includes the initial costs of the investment proposals, plus those costs that would be incurred for other investments likely to be required over the analysis period. If Transpower proposes an investment with a short term focus, the Commission is required under the Grid Investment Test, to adopt modelled projects ensuring that the required analysis over the 20 year period is able to be conducted. The existence of cheaper (in terms of initial investment cost) alternatives does not mean that a proposed investment cannot be considered and approved by the Commission under the first limb of the Grid Investment Test. But it will be evaluated against those alternatives. MEUG's concerns, which the Commission accepts are legitimate and very real, are taken care of by the comparative analysis required by the Grid Investment Test.

Alternative projects

The second and third grounds of MEUG's judicial review application challenged decision-making by the Commission (as an expert body) in technical areas. As such, the court noted that these grounds

would only succeed if the decision-making process was exposed as unreasonable. MEUG could only succeed on the second and third grounds if it persuaded the court that no reasonable electricity commission with the Commission's statutory task and, having before it information available to the Commission here, could have reached the decisions the Commission did.

In its second ground for challenging the decision of the Commission, MEUG argued that the Commission failed to evaluate or require Transpower to evaluate appropriate alternative projects. MEUG suggested three alternatives that should have been considered by the Commission against the proposal by Transpower (all were cheaper, more short term projects). The only alternative projects considered by the Commission were those presented by Transpower. MEUG submitted that the failure by the Commission to evaluate any short or medium term alternatives was "extremely imprudent", particularly as short term options would give the Commission more optionality as to grid investment planning (for example, a new power station could be built north of Auckland which would mean the potential repairs subsequent to a short term fix would be unnecessary). MEUG argued that the misapplication of the Grid Investment Test meant that the Commission gave too much weight to long term projects, and departed from the economic efficiency imperatives of the Act and the Rules.

MEUG's second ground for reviewing the decision of the Commission failed because the court did not consider MEUG had established unreasonableness on the part of the Commission in its alleged failure to evaluate or require Transpower to evaluate appropriate alternative projects. The court considered that the Commission has discretionary power to ask Transpower to evaluate alternative reliability investments and the Commission's exercise of that discretionary power was not unreasonable. The court considered that the approach taken by the Commission in its assessment of the Otahuhu Proposal was not unreasonable. That approach included the following:

- the Commission had published Transpower's proposal and sought written submissions, including as to any alternative project that should be considered. MEUG and other submitters submitted that Transpower should have included one of the three options now proposed by MEUG (the IGE option). No other option was advanced;
- the Commission considered the IGE options. It heard submissions before rejecting the proposal in its final decision because of the risk of stranding assets that the option entailed, the lack of any significant difference between the IGE option and one of Transpower's alternative options and that the IGE option was less efficient, when assessed over time, than either Transpower's second alternative or the Otahuhu Proposal.

The court also took into consideration the point made by the Commission and Transpower, which the court accepted, that even if the IGE option had been considered by the Commission as an alternative project, the result would have been no different, so any error in omission is immaterial. The court also considered it instructive that two of the options now proposed by MEUG were not advanced to the Commission when it sought suggestions as to other alternatives. The court accepted that this undermined MEUG's submission that the Commission was not reasonable in not looking at these options.

The court also did not accept MEUG's argument that the Commission unreasonably failed to consider the benefits of optionality (essentially the "wait and see" approach). On the evidence Justice Wild was satisfied that the Commission did weigh up the potential advantages of preserving optionality.

Interestingly, the court stated:

"Perhaps the main reason why the Commission did not consider the IGE option as an alternative project was its view that there was no significant level of uncertainty about future requirements at Otahuhu which made the IGE option – with its lower initial investment and consequent optionality benefits – the appropriate one. I agree with the respondents that the analysis (it is an NPV analysis with modelled projects substantially corresponding to option 1) carried out by the Commission is the sort of expert assessment which the Commission is well placed to make, and the Court ill placed to second guess."

Erroneous HILP

The focus of MEUG's challenge on the third ground was on the alleged inadequacy of the information on which the Commission based its high impact low probability assumption used to calculate its NPV analysis. The Commission's high impact low probability assumption (HILP assumption) was critical to the Commission's NPV analysis of the Otahuhu Proposal and the alternative options.

In its final decision on the Otahuhu Proposal, the Commission made conflicting statements on its basis for determining its HILP assumption. First it noted that it was not satisfied that it could safely rely on its own 1 in 500 year HILP assumption and instead chose to rely on Transpower's view that the June 2006 substation wide event at Otahuhu was a 1 in 100 year occurrence. But, later in its decision, it also noted that it "chose to exercise judgment, and adopted a notional probability reflecting that judgment, as to whether it is prudent to have Auckland... exposed to the prospect of a single major substation being affected by a low probability but high impact event."

MEUG argued that as a result of using inadequate information for its HILP assumption (as put forward by Transpower), the Commission could not be "reasonably satisfied" (as required by the Grid Investment Test) that:

- the proposed investment maximises the expected net market benefit or minimises the expected net market cost compared with a number of alternative projects; or
- that conclusion is sufficiently robust having regard to the results of the sensitivity analysis.

The court disagreed. In its opinion all the Commission was required to do under the Grid Investment Test was select a HILP factor based on its judgment guided by the available data. Faced with statistical data upon which it could not safely rely, the Commission "adopted a notional probability", albeit one that erred on the side of caution. In the court's view this was not unreasonable in the circumstances. This was particularly so given the critical importance of the Otahuhu substation in the coming years and the fact that both Vector and Genesis had also supported the Transpower's one in 100 year probability rate adopted by the Commission. The Grid Investment Test involves a qualitative as well as quantitative assessment, leaving scope for different views.

To access a copy of the *Major Electricity Users' Group Inc v Electricity Commission* decision [click here](#).
For further details on the Board of Inquiry Upper North Island Grid proposal visit the [Ministry for the Environment's website](#)

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Utilities and resources

More guidelines for decision-makers in the electricity sector

A new National Policy Statement on Electricity Transmission, an updated and revised Government Policy Statement on Electricity Governance, and a draft Grid Upgrade Investment Review Policy will provide the Electricity Commission, Transpower and other decision-makers with further guidance around electricity transmission and security of supply issues.

National Policy Statement on Electricity Transmission

The [National Policy Statement \(NPS\) on Electricity Transmission](#) took effect on 10 April 2008. It was developed as a result of the 2004 review of the Resource Management Act 1991 (the RMA) which found that lack of a clear statement on national interest on infrastructure led to insufficient weight being given to infrastructure of national significance in RMA plans and in local decision-making.

The NPS sets out the objective and policies for managing the electricity transmission network under the RMA with the overall purpose of making it explicit that electricity transmission, and the national benefits it provides, is a matter of national significance under the Resource Management Act.

The objective and policies are intended to guide decision-makers drafting plan rules, making decisions on the notification of the resource consents and in the determination of resource consent applications, and considering notices of requirement for designations for transmission activities.

For decision-makers under the RMA, the NPS is intended to be a relevant consideration to be weighed along with other considerations to achieve the sustainable management purpose of the RMA. However, the NPS is not a substitute for, nor does it prevail over, the RMA's statutory purpose or the statutory tests already in existence.

The government is currently also developing [National Environmental Standards on electricity transmission](#) to complement the NPS. The standards would do this by providing national consistency in how electricity transmission activities are managed, assisting councils in implementing the NPS rules, and providing for an increased national security of supply by protecting the national grid.

Government updates priorities for Electricity Commission

The Government Policy Statement (GPS) on Electricity Governance (dated October 2006) has been revised and updated following the recommendations of a [Cabinet Paper](#) and a public consultation on a [Draft GPS on Electricity Governance](#). The amendments take into account the government's changes in its security of supply policy in the electricity market and also reflect the Electricity Commission's role under the New Zealand Energy Strategy and New Zealand Energy Efficiency and Conservation Strategy released at the end of 2007.

Under the [new GPS](#) the Electricity Commission will:

- take responsibility for how wind generation can best be integrated into the system, along with consideration of where grid upgrades are necessary to get renewable electricity from the point of generation to where it is used;
- replace the '1 in 60 dry year' standard for security of energy supply in the GPS by a 'winter energy margin' (the margin between forecast capacity to supply in a mean hydro year and forecast demand) of 17% for New Zealand and 30% for the South Island; and
- develop and set security standards for adequacy of capacity to meet peak demand.

The commission will also be required to continue to closely monitor new generation build and security of supply projections and to make recommendations on policy responses, if required, to any identified systematic failure.

For further details visit the [Ministry of Economic Development's website](#).

Grid Upgrade Investment Review Policy

The Electricity Commission has prepared a draft [Grid Upgrade Investment Review Policy](#) (GUIRP) following a joint working group with Transpower set up in April 2007.

The GUIRP's purpose is to promote an effective process for the preparation of investment proposals by Transpower, as part of the company's wider grid-planning process, and the review and approval or rejection of those proposals by the commission. It provides a framework within which the commission and Transpower will interact during the process and provides guidance to interested parties on how Transpower and the commission will interact with them. However, since the GUIRP is only an operational policy and is not required by the Rules, the GUIRP will always be subject to any legislative requirements.

The Electricity Commission issued a [consultation paper](#) on the draft GUIRP:

- explaining the development of the GUIRP;
- setting out the purpose history and principles of the GUIRP; and
- seeking comments from interested parties on key aspects of the GUIRP.

Submissions closed on 5 May 2008 and it is expected that the GUIRP will be finalised in June.

Bell Gully News

Science and technology under the Crunch microscope

Bell Gully's popular Crunch Time seminar series returns in June to examine the importance of science and technology in raising New Zealand's competitiveness and standard of living.

Auckland waterfront and global Fletcher deal take top honours at Sydney awards

Fletcher Building's \$1 billion acquisition of the Formica Group and the project to revitalise Auckland's waterfront topped many other major deals to win two of the prizes at the Australasian Law Awards in Sydney.

Young lawyer dealing with complex human issues wins CLANZ-Bell Gully award

A talented young lawyer dealing daily with difficult legal and human issues is the winner of the 2008 CLANZ-Bell Gully Young Corporate Lawyer of the Year Award.

Emissions trading subject of capital summit

Emissions trading and its implications across key New Zealand sectors was on the agenda at a key summit in Wellington.

For further details and more news visit:

www.bellgully.com

Useful web links

New Zealand Government

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

New Zealand regulatory agencies and organisations

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

New Zealand commercial sites

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

Australian sites

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

International sites

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