

BELL GULLY



Commercial Quarterly

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Welcome to the Summer 2009 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:

- Responding to the financial crisis:
 - The Securities Disclosure and Financial Advisers Amendment Bill;
 - Securities Commission seeks views on changes to the listed share purchase plans and rights offers exemptions;
 - NZX proposes changes to the listing rules;
 - CMD Taskforce's interim report;
- Private placements to habitual investors: a recent case;
- Banning directors from corporate management roles;
- Moratorium proposals: what do investors need to know?;
- ASX issues reminder on continuous disclosure obligations surrounding periodic financial reporting;
- Supreme Court has last word on the effect of Part 15 amalgamations on third party contracts;
- RMA reforms signal a step in the right direction;
- Commerce Commission seeks views on applying new price control law;
- Recent trends in the Commerce Commission's approach to mergers;
- Keeping spam in the can: the Unsolicited Electronic Messages Act 2007;
- New approach for dry winters;
- Changes to the Government Policy Statement on Electricity Governance; and
- Emissions Trading Scheme review underway.

Previous issues of Commercial Quarterly are available on our website.

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

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

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Commercial business law

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RMA reforms signal a step in the right direction

In keeping with its pre-election promise, the Government announced in early February that it will be embarking on a significant series of reforms to the Resource Management Act (RMA). It has released a summary of proposed changes to the RMA, and confirmed that it expects to introduce a Bill into Parliament for enactment by August/September. A second raft of changes requiring more detailed consideration will follow later in the year. In this article, Bell Gully's Resource Management team provide a brief commentary on the proposed key changes.

Protecting the goodwill component of the purchase price

In many business sale transactions goodwill accounts for a substantial percentage of the value of the business. In such cases, to protect the goodwill component of the purchase price, the purchaser will usually insist that specific pre-completion and post-completion obligations are included in the sale and purchase agreement. In this case note, senior associate Michaela Hutton looks at a recent High Court case which provides an example of the remedies available to a purchaser should a vendor not fulfil these contractual obligations.

Commercial business law

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The facts of a recent High Court case¹ are typical of many joint venture arrangements. Two business people involved in a personal relationship decided to join forces and work together on a project with a view to making a profit. In this case, both parties were experienced property developers who agreed to develop two sites and explore the possibility of developing others. One party, the plaintiff, contributed her expertise in development and design and her access to trade discounts. The other party, the defendant, came up with the investment capital and was the sole shareholder and director of the company which owned the two sites.

Unfortunately for both parties, a year into the joint venture their personal relationship ended and so did the joint venture with substantial losses. The plaintiff claimed that the reason the joint venture did not make a profit was directly attributable to the actions of the defendant and brought proceedings against the defendant for compensation.

The claims

The plaintiff's claims differed for each of the sites being developed by the joint venture, as each site was at different stages of completion.

The first site had been completed and sold at a loss. The plaintiff argued that the first site would have sold at a profit if the defendant had not overspent on the development of the site. Since she had not agreed to some of the additional expenditure on the site, the plaintiff argued that a significant proportion of the costs incurred by the defendant in developing the site should not be chargeable to the joint venture. The plaintiff claimed she was entitled to a half share of the profits that the development of the site would have made but for the defendant's excess expenditure.

With regard to the second site, the plaintiff claimed that the defendant wrongfully terminated the joint venture by unilaterally instructing the builder not to start work on the first of the two townhouses planned for the site. Had the development of the townhouses on that site been allowed to proceed, the plaintiff claimed that this part of the joint venture would have made a profit of \$360,000 of which she would have been entitled to her half-share of \$180,000.

Alternatively, the plaintiff sought compensation for loss of the opportunity to make a profit, or for compensation for the time spent on the joint venture.

The defendant counterclaimed seeking a half share of the losses.

The court's decision

The contract

Although there was no formal written contract between the parties, the court found on the facts that there was a joint venture agreement in place to develop the two sites and to explore the possibility of other potential developments. The terms of the joint venture included an agreement that the defendant would pay all the costs associated with the development and he was also to bear any losses. The plaintiff and the defendant were to share equally in any profits arising from the developments.

The first site

There was no express term in the agreement requiring the defendant to consult with the plaintiff over expenditure incurred on the sites, but the court accepted that the defendant was under "a duty (whether

¹ *Sanders v Laing, Unreported Judgment H.C., Christchurch CIV 2006-409-002041, 20 October 2008*

expressed in terms of an implied contractual duty or a fiduciary obligation) to incur only such costs as were reasonable and necessary for the joint enterprise”.

On the facts the court found that the defendant had spent too much money on developing the site, but the court did not believe that this was the only reason for the resulting loss. In the court's view both the defendant and the plaintiff had made a miscalculation on the end value of, and the extent of the development appropriate for, the site. As such the court concluded that even if the defendant had been less “profligate”, it was difficult to conclude that the development would have made a profit. This part of the plaintiff's claim therefore failed.

The second site

The court agreed that the defendant was in breach of his contractual obligations to the plaintiff when he instructed the builder to stop work on the second site without the agreement of the plaintiff.

However, the plaintiff failed in her claim for loss of profits on the basis that the amount claimed was subject to too much uncertainty to justify an award being made. A quote had been given for constructing the first of the two townhouses on the site, but neither of the townhouses had been built. There was also a question of whether the development costs had been understated in the quotations and further issues over whether the townhouses would sell, or sell at the valuation figures.

The court did however agree that the plaintiff was entitled to compensation based on the loss of opportunity to make a profit. In doing so, the court disagreed with the defendant's argument that the Supreme Court in *Chirnside v Fay* (for a discussion on this case see the [Spring 2006 issue of Commercial Quarterly](#)) had disapproved of damages in a joint venture situation being awarded on a “loss of chance” basis. Justice French noted that the reason the Supreme Court disapproved of such an approach was because on the facts of that case the outcome of the joint venture was known and the joint venture had already demonstrated its profitability. In this case, these elements were not known and there was very much “an element of chance and contingency in relation to profitability”.

The problem for the court and the plaintiff in a loss of chance claim is that it is notoriously difficult to place a value on such loss. In reaching a figure of \$78,000 in this case the court took into consideration the amount claimed, less an amount for the probable understatement of costs and less a discount to reflect the risk of the townhouses not selling or not selling for their valuation amounts.

Compensation for work done

The court noted that it would not have awarded the plaintiff compensation on the basis of wasted expenditure (of her time) since this was not part of the terms of the joint venture agreement.

The counterclaim

The defendant's counterclaim for losses failed on the finding by the court that it was a term of the joint venture agreement that the plaintiff would not bear any share of the debt or the losses.

Practical implications

This case serves as a reminder that in any business venture between parties, no matter how friendly the relations between parties start out, it is never too early to consider putting a written contractual agreement in place. A lack of documentation is not going to alleviate responsibility and will often lead to unnecessary anguish and unfavourable outcomes for one, if not all, parties to the joint venture.

In particular, exit mechanisms and provisions for dealing with termination and remedies in the event of a default or breach of a party's obligations should be addressed at the outset and included as an essential part of any joint venture arrangement.

Commercial business law

RMA reforms signal a step in the right direction

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The RMA has been a key barrier to investment in infrastructure – delaying the decision-making process and creating uncertainty for investors and the public. In its initial round of reform of the RMA the government proposes to make the changes set out below.

Removing anti-competitive and frivolous objections

The amendments propose to address this by allowing the Environment Court to award security for costs, raising the filing fee from \$55 to \$500 for the lodgement of appeals and allowing applicants to potentially recover all the damages associated with an appeal brought by a trade competitor. However, the key question is – how will the court determine an anti-competitive or frivolous objector? Will there be specific criteria? To date, trade competitors have not been denied the opportunity to participate if they raise a "legitimate" RMA issue.

Streamlining consenting processes

The core objective of this round of reform is to make it easier to undertake infrastructure projects of national significance. The new range of options available for consent processing is a welcome opportunity for applicants to select the one that best suits their project and requirements. Some of the key changes proposed include:

- Provision to make applications directly to the Environmental Protection Authority (EPA), which is to be established in a shadow form in this round of reforms and fully implemented in stage two. The new regime has an additional criterion to the existing "call in" powers that is based on the operational infrastructure needs of a nationwide network utility operator. A new time-limit of nine months is introduced for a final decision on an application for a major project, unless the Minister extends the timeframe. While the details of how the EPA will be appointed and operate are still unclear, the infrastructure sector will welcome the chance for direct referral.
- Providing applicants or submitters with a right to choose that local authority-level decisions on notified applications are considered by an independent commissioner(s), selected by the local authority from people in the "Making Good Decisions" programme database. This is likely to meet the objective of reducing the influence of local politics on decision-making, however the requestor is liable for any costs.
- Applicants for resource consent and notices of requirement may request that their application be determined by the Environment Court without the need to go through the local authority consenting process, provided that the local authority has agreed. Given that history has shown that sometimes local authorities are reluctant to concede control of processing applications, it is hoped that commonsense prevails.

Reducing delays in introducing plans and plan changes

Amendments to reduce delays in the introduction of new regional and district plans and plan changes should refine the submission process. This includes removing the ability for appellants to make general challenges or ones that seek the withdrawal of entire proposed policy statements and plans. However, it is unclear whether removing the non-complying activity category will improve matters. How will councils consider the status of activities that have not been specifically considered or provided for? It is possible that we will simply see the development of two de-facto categories of discretionary activity – those expressly provided for and those arrived at by default.

Preparing plans

A number of proposals will improve the efficiency of all territorial authorities to produce plans, these include:

- enabling the regional council and all territorial authorities of a region to combine to produce a single RMA planning document;
- enabling national policy statements to direct that a local authority must change the objectives and policies of policy statements and plans without the need for further local planning processes;
- removing the requirement for territorial authorities to review their plans every 10 years; and
- establishing that rules in proposed plans will have no legal effect until the decisions made on submissions have been notified.

Limiting appeals to questions of law

The proposal to limit appeals on proposed policy statements and plans to questions of law, except in cases where the appellant has sought leave of the Environment Court, is concerning as it places undue reliance on the quality of decision-making by territorial authorities.

Further submissions

Removing the right to make further submissions on planning documents will require careful consequential management of the scope of jurisdiction and ability of parties to meaningfully participate in issues raised by other planning participants and to raise alternative solutions.

Other amendments

Other more minor amendments seek to improve the overall planning framework and consent processing by:

- removing the ability for blanket tree protection rules to be imposed in urban areas;
- limiting the ability of consent authorities to make repeated requests for further information;
- providing the Minister for the Environment and the Minister of Conservation with powers to cancel, postpone and restart a national policy statement development process that has already commenced at any time before it is gazetted. This effectively clarifies that a new government is not obligated to proceed with processes started by a prior government;
- amending the penalties able to be imposed under the RMA will give the courts wider powers particularly to allow the court to have the power to require a review of a resource consent held by an offender, and raising the maximum fine for offences under the RMA to \$600,000 for corporate offenders, and up to \$300,000 for private individuals. Although, in reality, the maximum fines have rarely been imposed;
- allowing enforcement actions to be taken against the Crown by local authorities; and
- requiring all councils to develop a discount policy for the late processing of consent applications will be an incentive to speed-up consent processing. Councils must also have a complaints process, and where the local authority is at fault, the applicant will receive a discount on the application processing fees and charges.

The next phase

The second phase of reform later this year is to include:

- establishing the structure of the Environmental Protection Authority;
- issues relating to aquaculture;
- improving fresh water allocation and management; and
- encouraging greater collaboration in city development and urban design.

Bell Gully looks forward to a vigorous debate on the proposed reforms and will be actively involved in each stage of the reform process.

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

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Commercial business law

Protecting the goodwill component of the purchase price

In many business sale transactions goodwill accounts for a substantial percentage of the value of the business. In such cases, to protect the goodwill component of the purchase price, the purchaser will usually insist that specific pre-completion and post-completion obligations are included in the sale and purchase agreement. In this case note, senior associate [Michaela Hutton](#) looks at a recent High Court case which provides an example of the remedies available to a purchaser should a vendor not fulfil these contractual obligations.

Generally speaking, a failure by one party to perform his or her contractual obligations will amount to a breach of contract. New Zealand law does not usually enforce the contract in the sense of compelling the parties to carry out their primary obligations. However, a breach of contract entitles the innocent party to maintain an action for damages.

Recent case

A recent High Court case² involved a claim for damages for various breaches of an agreement for the sale and purchase of a car dealing business.

Once the agreement had been entered into, the vendor had largely ignored its obligations under the agreement, breaching clauses including obligations to:

- carry on and maintain the business through the pre-completion period and to report regularly to the purchaser on the performance of the business;
- deliver a certain level of stock on completion;
- provide the business' trade contacts and customer database;
- observe a restraint of trade clause which prevented the vendor from dealing in cars for a period of three years in a specified region unless the vendor sold the cars through the purchaser's car dealing business; and
- mentor the purchaser post-completion.

All of the above clauses were aimed at ensuring that the purchaser received the full value of the goodwill included in the purchase - 85 percent of the purchase price was attributed to goodwill.

On the facts, Justice Wild did not consider that the purchaser received any net business value for the sum it paid for goodwill (a significant element of which was the restraint of trade) and the whole of that sum with interest was awarded to the purchaser as damages for the breach of contract by the vendor.

Practical implications

Allocating a figure for the goodwill component of the purchase price is often not a straight forward exercise. A purchaser will generally want to allocate less cost to non-taxable items such as goodwill, whereas the vendor has more incentive to allocate more value to goodwill because it is a non-deductible item.

This case highlights the importance of allocating a realistic figure for goodwill. In particular, a vendor should be aware that it cannot inflate the goodwill component by giving a restraint of trade and agreeing to provide trade contacts and databases and then breach such restraint or other obligations with impunity.

² *Image Services Ltd v Turfus Motor Court Ltd & Ors (Wild J, HC-Dunedin, CIV-2006-412-000992; 26/11/2008)*

Company law

Banning directors from corporate management roles

With New Zealand now well and truly in a recession we are seeing more and more company failures. Where a company fails as a result of mismanagement by directors, the public will want to know what will stop that director simply starting another company and "doing it all again". In this article, senior associate Louise Hill discusses how and when directors may be banned from being a director as a result of a company failure or other actions (or, most commonly, inactions) of the director.

Supreme Court has last word on the effect of a Part 15 amalgamation on third party contracts

In the final chapter of *Elders New Zealand Ltd v PGG Wrightson Ltd*, the Supreme Court has upheld the Court of Appeal and High Court interpretation of court ordered amalgamations under Part 15 of the Companies Act 1993. In this case note Bell Gully partner Jayne Kirton and solicitor Neetha Alex outline the court's decision and discuss its implications.

CAMAC Report released on Sons of Gwalia decision

In this update to his article "[Shareholder claims against insolvent companies: does Sons of Gwalia have implications for New Zealand?](#)" in the Spring 2007 issue of Commercial Quarterly, senior associate Tim Clarke reviews the Australian Corporations and Markets Advisory Committee's recent report which recommends that the Australian Government should leave the Sons of Gwalia decision to stand.

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INTRODUCTION

According to the Ministry of Economic Development's website, around 20 individuals have been banned from acting as a director and from participating in the management of a company each year since 2006. Most of these banning orders have related to directors of smaller companies.

In November 2008, the Deputy Registrar of Companies banned the three former directors of National Finance 2000 from being a director or involved in the management of a company for periods of four and a half years (two directors)³ and four years (one director) respectively. At the time of the decision the Ministry of Economic Development stated that a number of investigations were underway into directors from failed finance companies, but no further information was provided as to the identity of the persons being investigated or the status of the investigations. We wait to see the outcome of these investigations.

WHEN DIRECTORS MAY BE BANNED

The Companies Act contains a number of provisions directed towards the prohibition or banning of persons from acting as a director or being involved in the management of a company. There are generally three situations in which a person may be banned:

- automatically upon conviction for certain offences;
- by the court in certain circumstances upon the application of the Registrar of Companies, the Official Assignee, the liquidator of a company, or by a person who is or has been a shareholder or creditor of the company;
- by the Registrar of Companies in certain circumstances.

Automatic prohibition

Under section 382 of the Companies Act, a person who has been convicted on indictment of any offence in connection with the promotion, formation or management of a company, or of certain offences under the Companies Act or the Crimes Act involving dishonesty or fraud (including knowingly making a false or misleading statement in a document required by or for the purposes of the Companies Act and carrying on business fraudulently) is automatically prohibited from being a director or being directly or indirectly involved in the management of a company for five years. Such a person may, however, apply to the court for relief from this section, and the court may grant leave for the person to be a director or be involved in the management of a company.

There have been a number of decisions where a person has applied for leave of the court to act as a director, despite being automatically banned. The general approach of the court to such an application was stated by Justice Cook in *Re Minimix Industries Limited*⁴. In that case Justice Cook stated that there is a "substantial onus" on an applicant to demonstrate that leave should be granted as an exception to the general rule. While section 382 is not designed to be a punishment (as a person convicted of an offence which triggers section 382 will already have suffered a penalty in relation to such conviction), the section is intended to protect the public from those who have committed fraudulent acts. As stated by Justice Cook,

³ One of the directors, Mr Ludlow, has appealed the decision of the Deputy Registrar banning him from being a director for four and a half years.

⁴ (1982) 1 NZCLC 98,381

"the concern is for the interests of the public, and that those who have business with a company are entitled to find that they are dealing with persons of integrity. Creditors are entitled to expect that the funds of the company are not dissipated by dishonest action".

If there has been fraudulent wrongdoing which resulted in the automatic ban in the first place, this will weigh heavily with a court and the person will be unlikely to be granted leave. However, even where the conduct of the person in question does not amount to fraudulent misconduct, it will not be easy for the person seeking leave to convince the court that leave should be granted (as illustrated by the facts of *Re Weston*⁵).

Court-ordered prohibition

The court has the power, under section 383 of the Companies Act (although in practice, few applications are made under this section) to ban a director from being involved, directly or indirectly, in the management of a company for a period of up to 10 years, in certain specified situations. These include situations where a person has been convicted of an offence, or persistently failed to comply with obligations, under the Companies Act, the Securities Act 1978, the Securities Markets Act 1988, the Takeovers Act 1993 or the Takeovers Code. The circumstances which trigger an automatic ban under section 382 also qualify under section 383, and the court may be asked to impose a longer ban than the automatic five year ban under section 382.

In 2006, section 383 was extended to allow a court to ban a person who has been prohibited from acting as a director or taking part in the management of a company in an overseas jurisdiction in respect of substantially similar activities to those which lead to a director being banned in New Zealand. This change was made to limit the opportunities for such individuals to set up business in New Zealand.

Registrar-ordered prohibition

The most frequently used banning provision under the Companies Act is the power given to the Registrar of Companies under section 385 to prohibit a person from being a director or promoter of a company or being concerned in or taking part, whether directly or indirectly, in the management of a company during a period of up to five years. This power applies only in relation to companies that have failed⁶. The circumstances in which the Registrar may impose a prohibition under this section are:

- where the person was a director of a failed company and the Registrar is satisfied that the manner in which the affairs of the company were managed was wholly or partly responsible for the company failing;
- where the person was a director of (or concerned in or took part in the management of) two or more failed companies, unless that person satisfies the Registrar that the manner in which the affairs of all or all but one of those failed companies were managed was not wholly or partly responsible for them failing or that it would not be just or equitable for the power to be exercised.

In general it appears that most directors who face a banning order imposed by the Registrar are directors of small companies.

Banning of National Finance 2000 directors

A recent example of the Registrar exercising his power under section 385 is the banning of three former directors of the failed National Finance 2000 companies. The Deputy Registrar ruled that the three directors of National Finance 2000 Limited mismanaged the company and that it was this mismanagement that, at least partly, contributed to the company's failure. It was alleged that the directors breached their duties under the Companies Act, failed to maintain adequate books and records, and traded recklessly.

In the decision relating to Mr Ludlow, the Deputy Registrar reported that Mr Ludlow explained that he was very busy on operational matters and delegated all administrative matters to staff. Mr Ludlow stated that he became very reliant on the in-house accountant who managed all the audit and accounting processes

⁵ Asher J, High Court Auckland, 18 August 2006, CIV 2006-404-773

⁶ References to a company that has failed for the purposes of section 385 include a company that has been placed in liquidation or ceased to carry on business because of its inability to pay its debts, has been placed in receivership, has entered into a compromise or arrangement with its creditors, or is in voluntary administration.

along with all of the administration of the companies. The Deputy Registrar stated that it is the directors who have the fundamental responsibility to manage a company. In normal circumstances auditors or others do not stand in the shoes of a director. A director can only be excused responsibility from his duties if he is able to rely on the statutory defence in section 138 of the Companies Act which, subject to certain restrictions, recognises that directors may rely on reports, statements and financial data and other information prepared or supplied, and on professional or expert advice given, by employees, professional advisers or experts, or other directors.

Because more than one company had failed, the onus was on the directors to show that it was not due wholly or partly to their actions that the companies had failed. The Deputy Registrar noted that it would be possible to conclude that there were other factors involved in the demise of the companies, and yet the power of prohibition could still be exercised. The directors raised little in the way of defence and were not able to satisfy the Deputy Registrar that the matters alleged were not at least partly responsible for the demise of the companies.

In determining the appropriate period of prohibition, the Deputy Registrar stated that he must have primary regard for the protection of the public. In particular, the period of prohibition is not a punishment for failure of the companies, or because of the wide publicity surrounding the failure of a number of finance companies. The Deputy Registrar stated that the failings of the directors were serious and fundamental. Mr Ludlow stated that he "actively participated in the day to day running of the company's business". Therefore, he knew or should have known what was happening at the various companies. In addition, there were specific reports provided to him which meant that he was aware of certain staffing issues and could not blindly delegate and rely with confidence on the staff to perform the duties delegated. There was also information regarding the financial position of the companies which at a very minimum would have put him on inquiry. The Deputy Registrar also stated that it was apparent that there were deliberate breaches of the trust deed and cover ups. The Deputy Registrar pointed to a number of complete failures to understand the basic duties of a director, including interest free loans to Mr Ludlow and another director and loans to sister companies made without security.

One of the other directors, Ms Braithwaite, claimed that she was a non-executive director and relied on others so should not be held responsible for the failures of the companies. However, the Deputy Registrar did not accept this, as Ms Braithwaite was an employee of National Finance, and thus clearly an executive director. The Deputy Registrar was also concerned that the failure by Ms Braithwaite to appreciate the difference between an executive and a non-executive director may also mean that Ms Braithwaite did not understand her role and what her duties as a director entailed.

The Deputy Registrar concluded that the failings of the directors were serious and fundamental and there was a serious risk for creditors in the future unless a substantial period of prohibition was imposed. Mr Ludlow and Ms Braithwaite were banned from being a director for four and a half years. As noted above, Mr Ludlow is appealing this decision.

BANNING UNDER THE SECURITIES ACT

In addition to the Companies Act banning provisions, there are separate management banning provisions under the Securities Act 1978. If a director is convicted of any of the criminal liability offences under the Securities Act or a pecuniary penalty order has been made against a director, the court may, on application by an "entitled person", make a management banning order against that individual. An "entitled person" includes the Securities Commission, the Register of Companies, a company of which the individual is a director or was a director at the time of the matter which triggers the making of the management banning order, a liquidator of any such company or a person who is, or has been, a security holder or creditor of such company.

Under the terms of a management banning order, a person may be prohibited or restricted for a period of up to 10 years (without the leave of the court) from being a director or promoter of, or in any way being concerned or taking part in the management of, any incorporated or unincorporated body that carries on business in New Zealand.

A director who has been convicted of a criminal offence for distribution of an advertisement or registered prospectus which includes an untrue statement or in respect of which a pecuniary penalty order has been made, is automatically subject to a management banning order for a period of five years after the conviction or making of the pecuniary order.

COMMENT

It is imperative that directors are fully aware of their statutory and common law duties and the risks associated with failure to observe those duties. As increasing numbers of companies fail in the current

economic climate, we are likely to see enforcement bodies take an even more pro-active approach to enforcement action against individual directors whose actions have contributed to their company's demise.

Company law

Supreme Court has last word on the effect of a Part 15 amalgamation on third party contracts

*In the final chapter of *Elders New Zealand Ltd v PGG Wrightson Ltd*, the Supreme Court has upheld the Court of Appeal and High Court interpretation of court ordered amalgamations under Part 15 of the Companies Act 1993. In this case note Bell Gully partner Jayne Kirton and solicitor Neetha Alex outline the court's decision and discuss its implications.*

Reaffirming the previous courts' decisions, the Supreme Court in *Elders New Zealand Ltd v PGG Wrightson Ltd*⁷ held that an amalgamation (whether effected by Part 13 or Part 15 of the Companies Act) has the effect that the amalgamated company stands "in the shoes of the amalgamating companies". The amalgamating companies fuse into and continue in the amalgamated company. The amalgamating companies' rights and liabilities therefore continue in the amalgamated company without need for a process of transfer or vesting of such from the former to the latter. The amalgamated company is consequently not treated as a different party for the purposes of third party contractual arrangements.

The background facts

Elders and Wrightson were the co-owners of stock saleyards either in their own names or through certain of their associated companies. The parties' rights in relation to such saleyards were regulated by various agreements and the constitution of the co-owned companies, all of which granted each co-owner a right of pre-emption if the other sought to "transfer...or otherwise dispose...of its interest in the saleyards".

Wrightson and Pyne Gould Guinness subsequently sought and obtained High Court approval for entry by the parties into a scheme of arrangement under Part 15 of the Act pursuant to which Wrightson would amalgamate into Pyne Gould Guinness Limited (to be renamed PGG Wrightson Limited post-amalgamation). Elders brought proceedings in the High Court seeking a declaration that the arrangement involved a disposition by Wrightson to PGG Wrightson of Wrightson's interest in the co-owned companies thereby triggering Elders' pre-emptive rights in relation to such disposition.

The High Court found in favour of PGG Wrightson on the basis that an amalgamation implemented under Part 15 of the Act can have the same legal effect as an amalgamation effected under Part 13. Applying the decision in *Carter Holt Harvey Ltd v McKernan*⁸, the High Court therefore concluded that Elders' rights of pre-emption had not been triggered as Wrightson's interest in the co-owned saleyards continued in PGG Wrightson without need for a transfer/disposal to PGG Wrightson.

Following dismissal of an initial appeal to the Court of Appeal, Elders subsequently obtained leave to appeal to the Supreme Court.

The decision

Elders submitted that Part 15 of the Act is expressed in terms materially different from those of Part 13. Two significant aspects of Part 13 amalgamations, being the concepts of 'fusion' and 'continuance', are contained in section 219 of the Act. These concepts, which formed the basis of the decision in *Carter Holt Harvey Ltd v McKernan*⁹, are the notion that amalgamating companies (along with their rights and liabilities) fuse into and continue in the amalgamated company without calling into play the dynamics of a relationship involving a predecessor and successor. Part 15 of the Act does not contain a provision which is equivalent to section 219. Elders therefore contended that an amalgamation under Part 15 necessarily requires the amalgamated company to acquire each amalgamating company's assets and liabilities by a process of transfer or vesting.

⁷ [2008] NZSC 104.

⁸ [1998] 3 NZLR 403.

⁹ *Ibid.*

Elders argued that this need is reflected in the court's power under section 237(1) to make orders transferring or vesting property to give effect to a court approved arrangement. Elders further sought to support its interpretation of the legal effect of Part 15 amalgamations by citing the legislative history of that part of the Act. Part 15 is based on provisions that were first enacted in the United Kingdom and which were interpreted in *Nokes v Doncaster Amalgamated Collieries Ltd*¹⁰. The House of Lords decided by a majority in *Nokes v Doncaster Amalgamated Collieries Ltd*¹¹ that such provisions did not facilitate a statutory mechanism to effect or enable assignment of a contract of service from an amalgamating company to the amalgamated company on the basis of potential prejudice to third parties which such an interpretation would cause.

The Supreme Court found that the concepts of 'fusion' and 'continuance' apply to all amalgamations, whether effected by way of Part 15 or Part 13 of the Act. On that basis, the court held that Wrightson, along with its rights and liabilities, fused into and continued in PGG Wrightson. PGG Wrightson (as the amalgamated company) thereby holds the property of Wrightson by operation of law as if it were still Wrightson. There was accordingly no transfer or disposition of property triggering Elders' pre-emptive rights and Elders' appeal was dismissed.

Factors the court considered in reaching its decision were:

- Section 219 was specifically adopted for the purpose of providing a convenient mechanism to bypass the administrative complexity associated with having to effect separate transfers of property to the amalgamated company. It was therefore unlikely that Parliament would seek to retain such complexity in Part 15.
- The use of the term 'amalgamation' in both Parts 13 and 15 of the Act supports giving the term a consistent meaning.
- Section 237(1) is broadly framed and is intended to give effect to arrangements and compromises as well as providing greater flexibility if fusion of the amalgamating companies is inadequate on its own.

Practical implications

The decision of the Supreme Court clearly confirms that the meaning and effect of an "amalgamation" under Part 15 of the Act is the same as an "amalgamation" under Part 13. An amalgamated company continues to enjoy all advantages (and has the burden of all liabilities) previously conferred on any of the amalgamating companies. It is not to be treated as a new party or a different party to third party contractual arrangements.

Parties should therefore take care when drafting the terms of pre-emptive rights and change of control provisions to ensure that any trigger clauses are appropriately worded. Failure to do so may mean that such clauses will apply in a manner that does not suit the parties' requirements in the event that counterparties are involved in an amalgamation.

¹⁰ [1940] AC 1014.

¹¹ *Ibid.*

Company law

CAMAC Report released on Sons of Gwalia decision

In this update to his article "[Shareholder claims against insolvent companies: does Sons of Gwalia have implications for New Zealand?](#)" in the Spring 2007 issue of Commercial Quarterly, senior associate Tim Clarke reviews the Australian Corporations and Markets Advisory Committee's recent report which recommends that the Australian Government should leave the Sons of Gwalia decision to stand.

The Australian case *Sons of Gwalia*¹² has attracted considerable international interest by deciding that a shareholder's claim that he purchased shares during a period in which the company breached its continuous disclosure obligations should be classified as a creditor's claim in the course of the administration. The decision has significant implications for providers of debt finance and other unsecured creditors as well as the conduct of claims against insolvent companies.

Sons of Gwalia decision

In *Sons of Gwalia*, the administrators of a mining company applied to court for a declaration that an aggrieved shareholder did not have a provable claim against the company as a creditor in the proposed deed of company arrangement for the purposes of the company's voluntary administration. The question was whether the shareholder's claim arose "otherwise than as a member" of the company based on the statutory wording in section 563A of Australia's Corporations Act (Cth).

The High Court of Australia considered that the shareholder was not claiming in his capacity as a shareholder. Therefore, the claimant should be treated as an unsecured contingent creditor of the company. If the shareholder's claim was proved, it would rank equally with those of other unsecured creditors in any liquidation of the company.

The court rejected the suggestion that embodies a general policy of "members come last" in corporate insolvency and concluded that the expression in section 563A "in the capacity as a member" suggested that shareholders may have claims in a capacity otherwise than as members.

CAMAC Discussion Paper

Following the decision of the High Court of Australia in *Sons of Gwalia*, the Parliamentary Secretary to the Treasurer referred three questions to the Corporations and Markets Advisory Committee (CAMAC):

- Should shareholders who acquired shares as a result of misleading conduct by a company prior to its insolvency be able to participate in an insolvency proceeding as an unsecured creditor for any debt that may arise out of that misleading conduct?
- If so, are there any reforms to the statutory scheme that would facilitate the efficient administration of insolvency proceedings in the presence of such claims?
- If not, are there any reforms to the statutory scheme that would better protect shareholders from the risk that they may acquire shares on the basis of misleading information?

In September 2007, CAMAC published a discussion paper which set out the competing arguments and called for submissions on the following reform options with respect to the outcome in *Sons of Gwalia*:

- The first option was that *Sons of Gwalia* should be left to stand.
- The second option was to reverse *Sons of Gwalia* by amending the Corporations Act to provide that shareholder claims arising from misleading conduct by the company or breaches of the continuous disclosure regime were subordinated to the claims of ordinary creditors.
- The third option was to reverse *Sons of Gwalia* by amending the Corporations Act to provide that claims by shareholders arising from breaches of duty owed by the company are subordinated to the claims of unsecured creditors but given priority over the claims of other shareholders.

¹² *Sons of Gwalia Ltd v Margaretic* [2007] HCA 1.

CAMAC report and recommendation

Almost two years after the decision by the High Court of Australia, CAMAC released its report (*Claims by shareholders against insolvent companies: Implications of the Sons of Gwalia decision*) advising the Australian Government that as a whole the Advisory Committee was not persuaded of the need for change and that the law should be retained.

CAMAC concluded that the Australian Government should not legislate to overturn the Sons of Gwalia decision, or that aggrieved shareholders' claims should be postponed behind unsecured creditors or capped. CAMAC appears to have relied on ASIC's submissions about the importance of the continuous disclosure requirements. This is because most shareholders must rely on disclosure by public listed companies as they are not privy to internal company decisions and reports.

While CAMAC recognised the views of interested parties were polarised, it considered that claims by aggrieved shareholders can serve as a market-based deterrence, enforcement and recovery mechanism in support of regulation against corporate misconduct. CAMAC considered that any move to curtail the aggrieved shareholders' rights in relation to financially distressed companies could undermine the legislative intent to empower investors.

Additionally, CAMAC made some suggestions to streamline administrative processes. For instance, CAMAC proposed a standardised proof of debt form for claims by aggrieved shareholders. However, CAMAC considered that in the context of a review of shareholder claims against insolvent companies, it would be inappropriate to adopt the "fraud on the market" concept taken in the United States case law.

Early indications suggest that the Australian Government will likely accept CAMAC's recommendation.

Implications for New Zealand

Under New Zealand's statutory regime, a shareholder's claim against a company would not be subordinated to the claims of other creditors in the course of liquidation. Therefore, in terms of pure legal doctrine, the *Sons of Gwalia* decision and the CAMAC's recommendation to let the decision stand do not raise substantial implications for the approach of a New Zealand court.

However, as outlined in my earlier article on this case, the *Sons of Gwalia* decision does raise significant concerns about the implications of shareholders elevating their position in the course of liquidation. Based on the overseas experience, we expect to see a corresponding increase in the delay and complexity of the liquidation process and a dilution of the funds available to unsecured creditors.

Given the increase of financially distressed companies in a global recession, it is also likely that we will see more claims being brought by aggrieved shareholders against insolvent companies under investor protection legislation.

To access a copy of CAMAC's report *Claims by shareholders against insolvent companies: Implications of the Sons of Gwalia decision* (December 2008) visit the Australian Government's website at www.camac.gov.au.

Securities and capital markets

Responding to the financial crisis: the Securities Disclosure and Financial Advisers Bill

In this article, senior associate Stephen Layburn discusses the key provisions outlined in the new Securities Disclosure and Financial Advisers Amendment Bill which was introduced into Parliament on 18 February 2009.

Responding to the financial crisis: Securities Commission seeks views on changes to exemptions for listed share purchase plans and rights offers

The Securities Commission has sought comments on three options for exemptions to assist listed issuers to raise capital through limited offers to existing security holders, in light of recommendations made by the Capital Markets Development Taskforce and NZX.

Responding to the financial crisis: Proposed changes to NZX's listing rules

In December 2008, NZX released an exposure draft of its proposed changes to the Listing Rules of the NZSX/NZDX and NZAX Markets.

Responding to the financial crisis: CMD Taskforce's interim report

This article updates an earlier article by senior associate Stephen Layburn (posted on our website in December 2008) which reviewed the Capital Market Development Taskforce's interim report. The government has acted quickly to give effect to some of the Taskforce's key proposals.

Moratorium proposals: what do investors need to know?

In this article, partner Glenn Joblin discusses the level of disclosure which will be required for future issuers proposing a moratorium based on the experiences gained from the first round of moratorium proposals and a recent guidance note released by the Securities Commission.

Private placements to habitual investors: a recent case

The "habitual investor" exception provided by the Securities Act for private placements has been considered in a recent court decision involving offers of interests in a Queensland property development by companies controlled by property developer Dan McEwan. In this article, senior associate Stephen Layburn discusses some implications of this decision and notes some recent developments which may result in future improvements for New Zealand's private placement regime.

NZX listed issuers should take note of a recent ASX reminder on continuous disclosure obligations surrounding periodic financial reporting

In its January 2009 Companies Update, ASX has provided further guidance to ASX listed issuers on their disclosure obligations in the period leading up to the deadline for lodging periodic reports for half-year or annual reporting periods where there is expected to be a material difference in the issuer's financial results.

Updated guide on the trans-Tasman mutual recognition scheme for offers of securities

The Securities Commission and the Australian Securities and Investments Commission (ASIC) have released a new version of their joint guide on the trans-Tasman mutual recognition scheme for offers of securities introduced in June 2008.

Director loses appeal over false offer document

The director of a Dunedin-based company failed to get his convictions and sentences dismissed in relation to an advertisement on the internet offering securities to the public containing untrue statements.

Securities and capital markets

Responding to the financial crisis: the Securities Disclosure and Financial Advisers Bill

In this article, senior associate [Stephen Layburn](#) discusses the key provisions outlined in the new Securities Disclosure and Financial Advisers Amendment Bill which was introduced into Parliament on 18 February 2009.

The Securities Disclosure and Financial Advisers Amendment Bill contains key measures aimed at streamlining raising of capital for New Zealand businesses.

Flowing from the first round of recommendations of the Capital Market Development (CMD) Taskforce for steps to respond to current financial conditions, they are particularly relevant for listed issuers and also reflect recommendations made by NZX. (For further details on the CMD Taskforce and NZX recommendations, see the following articles in this issue of Commercial Quarterly: ["Responding to the financial crisis: CMD Taskforce's interim report"](#) and ["Responding to the financial crisis: Proposed changes for NZX listing rules."](#))

Central to the bill's key provisions is the objective of making it easier for businesses to raise capital by introducing a simplified disclosure prospectus regime into the Securities Act 1978, doing away with a lot of duplicated information for NZX-listed issuers. At the same time, the simplified disclosure prospectus aims to ensure that timely and accurate disclosure of information is made to prospective investors.

The contents of the new simplified disclosure prospectus will be contained in regulations which, we understand, are currently being worked on. Once implemented, the new simplified disclosure prospectus will enable listed issuers to offer certain debt and equity securities without the need to duplicate information that is already made publicly available through the NZX continuous disclosure regime. Specifically, the bill's explanatory notes say that listed issuers will only be able to use the simplified disclosure prospectus route to issue securities of equal or higher rank than those securities already on issue.

The bill also proposes technical changes to categories of people exempt from disclosure requirements, making it easier for all companies - both listed and unlisted - to raise capital.

The bill also makes a number of minor, technical, amendments to the Financial Advisers Act 2008 which include amendments to rectify the error relating to the territorial scope of that Act outlined in our article ["Financial Advisers Act - territorial scope"](#) in the Spring 2008 issue of Commercial Quarterly.

Simplified disclosure prospectus

A new definition has been inserted in the Securities Act to provide for use of the simplified disclosure prospectus by those issuers subject to continuous disclosure obligations. Background to the decision-making process that led to this new category of disclosure document are outlined in the bill's notes and traverse the possible legislative responses to the CMD Taskforce's initial recommendations released in November.

In particular, the notes make it clear that the preferred option for removing unnecessary impediments to capital raising by listed issuers is to use a new, single (simplified), offer document that relies on the information already made publicly available pursuant to the issuer's continuous disclosure obligations and any additional information material to the offer.

The obvious advantage for listed issuers is to reduce the time and cost of complying with the full (prospectus and investment statement) disclosure regime. The simplified disclosure prospectus would not seek to reduce the amount of information available to investors, instead simply to reduce duplication. As a result, relevant announcements and information made through the continuous disclosure regime will need to be referenced (incorporated by reference) in a simplified disclosure prospectus and made available to investors.

The provisions in the Securities Act relating to liability, penalties and remedies for the disclosure of false or misleading information will continue to apply to a simplified disclosure prospectus in the same manner that they do to a full prospectus. However, the quid pro quo for the maintenance of these obligations is that the

due diligence defences provided by the Securities Act in relation to the existing disclosure regime will also be available for a simplified disclosure prospectus. By contrast, the simplified disclosure regime being used in Australia to facilitate rights issues by listed issuers, using a very simple offering memorandum and a 'Cleansing Statement', does not provide the issuer and its directors with the same protections.

The additional changes made to the Securities Act to accommodate the use of a simplified disclosure prospectus include:

- creating an exception so that simplified disclosure prospectuses that refer to financial statements do not need to be accompanied by a copy of those financial statements; and
- providing a mechanism for the Securities Commission to make an extension order (extending the period within which securities may be allotted pursuant to a simplified disclosure prospectus) in three specified circumstances – two of which concern an issuer disclosing information that may have an adverse effect on the issuer and is material to the offer and the final one of which concerns an issuer failing to comply with its continuous disclosure obligations.

The bill also includes a mechanism and an example (which itself is a new development) for dealing with such an extension order. That example helps explain an investor's options if an extension order is made by the Securities Commission. Those options are to actively re-subscribe for the securities, to require that the investment be repaid or a "do nothing" option which preserves the investor's existing rights under the Securities Act to require the repayment of a subscription paid in respect of a "voidable allotment" within a period of up to 12 months.

Amendments to existing safe harbours in the Securities Act

Pleasingly the bill also contains changes to the exceptions in sections 3(2) of the Securities Act and to the "eligible persons" regime.

The effect of the amendment to section 3(2) is to provide that an offer of securities made only to persons who have previously paid a minimum subscription of at least \$500,000 for (initial) securities in a single transaction is not an offer of securities to the public to which the prospectus disclosure regime applies. However, there are some restrictions including that:

- the further securities offered must be identical to those initial securities; and
- the offer of further securities must be made within 12 months of the first allotment of the initial securities.

The proposed changes to the "eligible persons" regime amend anomalies in the original wording of that concessionary treatment enabling offers of securities to be made to "eligible persons" without the need for a prospectus or investment statement. The proposed amendments:

- allow a single offer of securities to both categories of "eligible person" (i.e. "wealthy" or "experienced" persons) and persons who are deemed not to be members of the public under the safe harbours provided by section 3(2) of the Securities Act, correcting an anomaly where the offer could only be made to one category but not both categories together;
- clarify that a family trust is a "person" for the purposes of applying the eligible person criteria; and
- allow certification that a person is "wealthy" every 12 months rather than every six months.

These changes apply to both listed and unlisted issuers and will help facilitate private placements in the SME market, particularly for start-ups and "angel investors".

What's next?

The detail and content of the simplified disclosure prospectus will be contained in regulations which are yet to be promulgated.

The bill's explanatory note says that, in addition to background work first undertaken by the Ministry of Economic Development (MED) in 2006 and the interim report of the CMD Taskforce, the urgency attached to this reform package has meant that MED has limited consultation to discussions with a targeted group of industry participants. There has been close co-operation with the Securities Commission and consultation with Treasury and the Prime Minister's department. Officials have also notified Australian authorities in the context of the trans-Tasman mutual recognition regime.

The bill is now with the Commerce Select Committee which must report back to the House by 30 April 2009. The Minister of Commerce, Simon Power has issued a statement encouraging industry and investors to be actively involved in the development of the bill during the select committee process, although as yet submissions have not been called.

While the devil will be in the detail of the regulations governing the content of the simplified disclosure prospectus, the speed and decisiveness with which the relevant policy decisions have been made to introduce the bill are encouraging.

The rapid introduction provides a further signal of the willingness with which officials have been prepared to address the need for New Zealand businesses to be able to raise capital quickly to respond to the pressures being brought to bear by the existing financial conditions.

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Securities and capital markets

Responding to the financial crisis: Securities Commission seeks views on changes to exemptions for listed share purchase plans and rights offers

The Securities Commission has sought comments on three options for exemptions to assist listed issuers to raise capital through limited offers to existing security holders, in light of recommendations made by the Capital Markets Development Taskforce and NZX.

Background

The Securities Commission released a discussion document at the end of last year to help it decide whether there are useful changes that can be made to its current share purchase exemption (the Securities Act (NZX – Share and Unit Purchase Plans) Exemption Notice 2005) to assist capital raising by listed firms in the short term, within the current policy of the law.

The consultation arises from a proposal made by the Capital Markets Development Taskforce (CMD Taskforce) to extend the Commission's existing class exemption for share and unit purchase plans in an interim report released in November 2008. NZX has also proposed rule changes to reflect this proposal in its review of its listing rules (subject to the relevant changes being made to the exemption notice). (For further details on the CMD Taskforce and NZX recommendations, see the following articles in this issue of Commercial Quarterly: ["Responding to the financial crisis: CMD Taskforce's interim report"](#) and ["Responding to the financial crisis: Proposed changes for NZX listing rules"](#).)

CMD Taskforce's proposed amendment

The current exemption notice was introduced in 2005 to allow listed issuers (companies and unit trusts) to extend small offers to existing security holders without requiring the production of a registered prospectus or investment statement (on the basis that existing security holders will be fully informed about the issuer through the NZX continuous disclosure rules) to a maximum value of \$5,000 per security holder per year. The CMD Taskforce's interim report suggests that the existing \$5,000 per security holder per year limit in the class exemption notice be raised to \$25,000.

The Commission is concerned that extending the limit in the share purchase plan exemption from \$5,000 to \$25,000 may undermine the current rationale for this exemption, in that it may be difficult to regard investments of \$25,000 per year as small investments for retail investors. An important policy consideration for the Commission when it granted the 2005 exemption was that the exemption apply only to relatively small offers of securities, so that the individual risk for each shareholder was comparatively low.

Alternative options

As alternatives to the CMD Taskforce's proposal, the Commission has put forward two further options for consideration. These options are:

- To grant an exemption so that listed issuers can issue shares up to 10% of their market capitalisation in any year, with a fixed amount offered to each shareholder and without a prospectus or investment statement.
- To grant an exemption allowing listed issuers to make pro-rata rights offers up to 10% of the number of shares already on issue, without a prospectus or investment statement, subject to a cap on the overall amount that could be raised using the exemption in any 12 month period.

The Commission prefers the latter of these two alternative options. In the Commission's opinion this option would strike an appropriate balance in that it would provide companies with a useful level of additional capital while limiting the individual exposure for shareholders to a relatively modest proportion of their existing investment.

Exemption conditions

It is the Commission's initial view that whichever exemption relief is adopted, the exemption should remain limited to non-renounceable offers, so that only existing shareholders, who have some familiarity with the company and with the continuous disclosure regime, can take up an offer that is made without the usual offer documents. It also proposes to keep any exemption for pro-rata rights issues subject to disclosure and other conditions generally consistent with those in the existing share purchase plan exemption.

Next steps

Submissions on the discussion document closed on 20 January 2009. The discussion document indicated that the Commission would consult further on the drafting of an exemption notice if it decided to amend its existing class exemption, or to grant any new exemption. Its intention was to have any changes in place by February 2009, but to date there have been no further public announcements from the Commission.

We will keep you informed of any further developments.

To access a copy of the discussion document "Exemptions for listed share purchase plans and rights offers" visit the Securities Commission's website at www.seccom.govt.nz.

For more information on share purchase plans refer to the article "[Changes to increase the benefits of share purchase plans](#)" in the Summer 2007 issue of Commercial Quarterly.

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Securities and capital markets

Responding to the financial crisis: Proposed changes to NZX's listing rules

In December 2008, NZX released an exposure draft of its proposed changes to the Listing Rules of the NZSX/NZDX and NZAX Markets.

On 15 December 2008, after considering submissions on the draft amendments to the Listing Rules of the NZSX/NZDX and NZAX markets (Listing Rules) outlined in NZX's November 2008 consultation paper (see our article ["NZX proposes reforms to capital raising and capital flexibility for listed issuers"](#) in the Spring 2008 issue of Commercial Quarterly), NZX released:

- an exposure draft (Exposure Draft) containing the summary of its policy decisions; and
- the form of proposed amendments (Proposed Amendments) to the Listing Rules.

It appears that the majority of submissions on the consultation paper were supportive of the NZX's draft amendments to the Listing Rules. Consequently, the majority of the Proposed Amendments (summarised below) reflect the substance of the draft amendments put forward in the consultation paper. However there is one notable exception. NZX has decided to delay implementing its proposal to enable a pro-rata Rights Issue or Debt Issue to be made by means of a "Term Sheet Offering Document" in place of prospectus-length disclosure documents until the relevant legislative changes are in place to facilitate this proposal.

NZX has also decided to defer consideration of the controversial proposal in the November consultation paper that only minority shareholders may vote on the remuneration, appointment or reappointment of independent directors and the proposal to reduce the obligation to obtain an independent Appraisal Report under Listing Rules 4.5.8, 6.2.2 and 9.2.5 to an option to obtain such a report.

Summary of Proposed Amendments

Rights Issues – timetable

- The Proposed Amendments decrease the prescribed time period to complete a rights issue from six to three weeks.

Per-shareholder capital offerings

- The Proposed Amendments extend the exemption under the Securities Act (NZX – Share and Unit Purchase Plans) Exemption Notice 2005 (**SPP Exemption**), which permits limited equity fundraising by Issuers without an investment statement and prospectus, from \$5,000 to \$25,000 per security holder in any 12 month period. NZX notes that consideration should be given to extending the terms of the SPP Exemption to the issue of debt securities or hybrid debt/equity securities. These changes are subject to the Securities Commission making the necessary changes to the SPP Exemption. (For further details see the article: ["Responding to the financial crisis: Securities Commission seeks views on changes to exemptions for listed share purchase plans and rights offers"](#) in this issue of Commercial Quarterly.)

Private placements

- The Proposed Amendments increase the threshold for issues of securities by NZSX Issuers by way of private placements from 15% to 20% of the class or number of that Issuer's equity securities in any 12 month period (and from 20% to 25% for NZAX Issuers).
- Directors of the Issuer and associated persons of such directors or employees of the Issuer will also be able to participate in such private placements, subject to certain conditions being satisfied. These include requiring a board certificate that the participation of such persons in the issue is in the best interests of the Issuer and shareholders generally. NZX does not state which directors will be required to sign the certificate, but does state that not all directors will be required to sign it.

- A consequential amendment will also be made to the Related Parties provisions in respect of the director/employee component of such a private placement. See second bullet point under "Related Party Transactions – materiality" below.

Non-pro-rata issue of voting securities

- The Proposed Amendments remove the requirement to obtain NZX approval for non-pro-rata offers if the 90% VWAP test on the issue price of voting equity securities is not satisfied.
- Directors will now need to certify they have made reasonable endeavours to get the best possible price for the issue of the securities if the issue price is less than 85% of the five day VWAP price for the securities. The certification will mirror the existing requirements of section 47 of the Companies Act 1993.

Remuneration of directors by stock

- The Proposed Amendments provide for directors to be remunerated by the issue of securities, with shareholder approval. Currently, the Listing Rules only contemplate monetary remuneration. This change will assist Issuers to align management and shareholder interests more closely and give companies more flexibility in the way they remunerate directors in periods of cash constraint.

Related Party transactions – materiality

- The Proposed Amendments increase the thresholds for entering into Related Party transactions from 5% of average market capitalisation to 10% for transactions and from 0.5% to 1% for the provision of services. This change reflects the impact of falling market capitalisations.
- In addition, where the private placement involves the participation of the directors (and their associated persons) or employees, only the value of the securities being issued to such persons will be taken into account when deciding whether the private placement is a material transaction.

It should be noted that NZX has stated that it will not stipulate that a Related Party transaction is Material Information (requiring disclosure pursuant to the continuous disclosure obligations); it is for the issuer to make that evaluation. Further, NZX is not considering increasing the de minimis value threshold for a material transaction which is currently \$250,000.

Share buybacks and Employee Share Schemes

- The Proposed Amendments remove the restriction on the buyback of securities from employees, which is currently perceived as a costly prohibition for buybacks under employee share option schemes.

Financial assistance to employees

- The Proposed Amendments increase the threshold of permitted financial assistance to employees from 5% to 10% of an Issuer's average market capitalisation.
- NZX also noted that there appears to be support for abolishing the requirement to provide shareholders with a disclosure document regarding the provision of financial assistance under the Companies Act 1993. Instead, sufficient disclosure could be achieved by a number of electronic means including the NZX market announcements platform.

Future changes

Pro-rata Rights Issues/Debt Issues

In NZX's November consultation paper a proposal was put forward which, if implemented, would allow Issuers to raise additional capital without the need for prospectus-length disclosure documents. Instead, an Issuer in compliance with its continuous disclosure obligations would be permitted to raise equity, on a pro-rata basis, from its existing shareholders and to raise debt using a "Term Sheet Offering Document".

The Exposure Draft noted clear support for the concept of a Term Sheet Offering Document in the submissions received on the consultation paper. However, as noted above, the NZX has decided not to progress this change until the necessary legislative changes are put in place. This is likely to be sooner than expected with the introduction of the Securities Disclosure and Financial Advisers Amendment Bill introduced in February 2009. The changes proposed to the Securities Act 1978 by this bill provide for a new simplified disclosure prospectus to enable listed issuers to offer certain debt and equity securities without the need to duplicate information that is already made publicly available through the NZX continuous disclosure regime. However the detail and content of the simplified disclosure prospectus will be contained in regulations which are yet to be promulgated. (For further details on the bill see the article ["Responding to the financial crisis: the Securities Disclosure and Financial Advisers Amendment Bill"](#) in this issue of Commercial Quarterly.)

NZX has highlighted a number of indicative policy decisions which will be refined once the legislative changes are made:

- While the form of the Term Sheet Offering Document will be dependent on the legislative changes, NZX expressed a preference for a "certificate" signed by the directors that the Issuer had complied with its continuous disclosure obligations. This is a departure from the proposal in the November consultation paper for a "warranty" to be signed by the CFO, CEO and the Board.
- The Term Sheet Offering Document would be available for renounceable rights issues.
- The "risks" section of the Term Sheet Offering Document would be limited to those risks that are material to the particular security being offered.
- NZX envisages that the Securities Act rather than the Listing Rules would govern the liability regime (which is consistent with the proposed changes in the Securities Disclosure and Financial Advisers Amendment Bill). NZX also notes that, under existing legislation, it is likely that liability for the warranty/certificate would be governed by the provisions in the Securities Act 1978 relating to advertisements which only extend to directors.

NZX Timetable

In the timetable outlined in the Exposure Draft, NZX indicated that it would submit the finalised Proposed Amendments to the Minister of Commerce by 30 December 2008, with the new rules coming into effect in early March (allowing for the 40 working days given to the Minister under the Securities Markets Act to disallow all or part of the proposed changes). However, there have been no public announcements to confirm whether this timetable is still on track.

We will keep you informed of further developments.

For a copy of:

- the [NZX Exposure Draft click here](#);
- the [NZX Summary of Rule Changes click here](#),

or visit NZX's website at www.nzx.com.

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Securities and capital markets

Responding to the financial crisis: CMD Taskforce's interim report

This article updates an earlier article by senior associate [Stephen Layburn](#) (posted on our website in December 2008) which reviewed the Capital Market Development Taskforce's interim report. The government has acted quickly to give effect to some of the Taskforce's key proposals.

Background

The Capital Market Development Taskforce interim report (released in November 2008) contains a package of proposals designed to boost access to capital for New Zealand businesses and reduce the cost of raising capital.

While the taskforce is not due to report its findings until September 2009, it decided to produce an interim report in response to the financial crisis, with taskforce chairman Rob Cameron noting that, in the current environment, access to capital will be a key issue in determining business survival. While there are a wide range of interventions that governments can take and are taking to reduce the impact of the crisis, capital markets are an important piece of the picture, he said.

The CMD Taskforce's proposals include recommendations for changes to the NZX Listing Rules, developed with NZX. They feature in a separate [consultation paper](#) released by NZX in November 2008 (which was followed up by an [exposure draft](#) of proposed changes to the NZX listing rules in December 2008). For details of the NZX changes see the article ["Responding to the financial crisis: Proposed changes to NZX's Listing Rules"](#) in this issue of Commercial Quarterly.

Recent developments

Since the release of the CMD Taskforce's report, the government has acted quickly to give effect to some of the taskforce's key recommendations with the introduction of the Securities Disclosure and Financial Advisers Amendment Bill in February 2009.

Once this bill is implemented, a new simplified disclosure prospectus will enable NZX-listed issuers to offer certain debt and equity securities without the need to duplicate information that is already made publicly available through the NZX continuous disclosure regime. The bill also proposes technical changes to the categories of people exempt from disclosure requirements, which are in line with the taskforce's recommendations noted below.

The bill's explanatory note says that, in addition to the CMD Taskforce's report and earlier background work undertaken by the Ministry of Economic Development (MED) in 2006, the urgency attached to this reform package has meant that MED has limited consultation to discussions with a targeted group of industry participants. There has been close co-operation with the Securities Commission and consultation with Treasury and the Prime Minister's department. (For further details on this bill please refer to the article ["Responding to the financial crisis: the Securities Disclosure and Financial Advisers Amendment Bill"](#) in this issue of Commercial Quarterly.)

CMD Taskforce's recommendations

The taskforce's recommendations concentrate on easing barriers to raising capital without undermining investor protection. A number will require changes to legislation (some of which are included in the Securities Disclosure and Financial Advisers Bill noted above). The taskforce has separated its recommendations into those it considers can be implemented quickly and others which it acknowledges may require further work (but which it suggests should be progressed urgently).

In making recommendations, the taskforce noted that it had reference to two broad principles:

- (a) That relevant information about public issuers which are already subject to (and comply with) continuous disclosure obligations will be known to the market. As a result, much prospectus-level

disclosure is costly duplication and a simpler offer document could be used which contains relevant information without undermining investor protection. This is in keeping with practice in Australia.

- (b) A number of the existing exemptions enabling public issuers to issue securities without offer documents can be simplified and clarified.

The interim report also identifies additional changes which the CMD Taskforce considers have merit but require further consideration.

The CMD Taskforce has summarised its recommendations for urgent change in the table set out below:

Recommendations for urgent change			
Proposal	Reduces cost and time with capital issuance	Potential impacts on investors	Other impacts
Ease requirements for listed debt issues	✓	Minimal	
Raise threshold for subsequent equity issues by listed companies before prospectus disclosure and shareholder approval is required	✓	Minimal	
Reduce timeframes for rights issues	✓	Minimal	
Increase the amount of capital that can be raised in secondary offerings without shareholder approval	✓	Minimal	
Allow remuneration of employees and directors by stock		Positive	Helps cash flow
Making exemption for non-public issue offers more practical	✓		Reduces risk for issuers
Amend Securities Act to allow persons who have invested \$500,000 to make incremental investments without a prospectus or investment statement	✓		
Amend the wording of financial assets test in "eligible persons" exception to cover trusts	✓		
New power for the Securities Commission to issue "no action" letters	✓		
Focus prospectus disclosure on meaningful items	✓	Minimal	
Streamlining Overseas Investment Commission consent	✓		

Urgently recommended changes for listed companies

The interim report discusses briefly each of the recommended changes. These are summarised as follows:

1. Ease requirements for listed debt issues

The taskforce notes the restrictions on normal debt funding from banks and suggests it is critical to allow debt issues to proceed as rapidly as possible with minimum compliance costs. Therefore, instead of an investment statement and prospectus, listed issuers should only be required to produce the following for (listed) debt issues:

- (a) a simple term sheet offering document listing the terms of the debt issue; and
- (b) a warranty from a CEO, CFO and Board of Directors that the issuer has complied with its continuous disclosure obligations under the NZX Listing Rules – including that they have no knowledge of any information which, if disclosed, would be relevant to an assessment of the offer (and any new material developments during the offer period would be disclosed to the NZX).

This is similar to the NZX recommendations made in its November consultation paper.

2. Raise threshold for subsequent equity issues

The taskforce recommends the raising of the threshold for shareholder approval and disclosure documents for subsequent equity issues to existing shareholders from NZ\$5,000 to NZ\$25,000. (The Securities Commission has acted on this recommendation by issuing a discussion paper in December 2008 to determine whether changes should be made to the Securities Act (NZX – Share and Unit Purchase Plans) Exemption Notice 2005. For further details see the article: [“Responding to the financial crisis: Securities Commission seeks views on changes to exemptions for listed share purchase plans and rights offers”](#) in this issue of Commercial Quarterly.)

As an alternative, the taskforce suggests that the requirement for listed issuers to prepare a prospectus before issuing equity to existing shareholders be removed entirely because the issuer is already subject to continuous disclosure.

3. Reduce timeframes for rights issues

This recommendation is similar to the proposals made by the NZX in its consultation paper – the taskforce recommends reducing the timeframe for approval of offering documents and the period that a rights issue must remain open for acceptance.

4. Increase the amount of capital that can be raised in secondary offerings without shareholding approval

Again this recommendation is similar to the NZX recommendations. The taskforce recommends increasing the threshold for secondary offerings without shareholder approval from 15 percent of market capitalisation per year to 20 percent.

5. Allow remuneration of employees and directors by stock

The taskforce recommends allowing greater flexibility for remuneration of employees and directors by stock, helping align management and shareholder interests and providing flexibility for businesses which are cash constrained. The recommendation would allow listed issuers to pay in stock at levels approved by shareholders at an annual meeting.

6. Making the exemptions for non-public offers more practical

The taskforce recommends the removal of the current restriction preventing an issuer making an offer at the same time to persons who are deemed not to be members of the public in terms of section 3(2) of the Securities Act and "eligible persons" under section 5(2CB) of the Securities Act.

7. Facilitate incremental investments

The taskforce recommends the amendment of section 3(2)(a)(iia) of the Securities Act to allow subsequent incremental offers to persons who have invested at least \$500,000 – without a prospectus or investment statement.

8. Amendment of the "eligible persons" exception to cover trusts

The taskforce recommends amending section 5(2CB) of the Securities Act to make it clear that "eligible persons" includes a trust. A similar concession is permitted in Australia. In addition, in keeping with Australian legislation, it is recommended that the certification regime required under the "eligible persons" provisions apply for 12 months (rather than six) limiting the number of times that such certificates need to be refreshed.

9. Enable the Securities Commission to issue "no action letters"

The taskforce notes that it has received market feedback that the inability of the Commission to issue no action letters has stifled the introduction of new products.

10. Focus on meaningful disclosure

The taskforce recommends a number of simple changes to the Securities Regulations to reduce the cost to issuers without reducing investor protections:

- (a) amending the restrictions in Regulation 12 limiting references to more up-to-date financial information – which is problematic for an issuer whose business is deteriorating;
- (b) removing the limits in Regulation 15 on providing prospective financial information other than by means of a prospectus; and
- (c) fast-tracking the Securities Commission's current review of required changes to the Securities Regulations to reduce compliance costs.

11. Streamlining OIO consent

The taskforce notes that virtually every law firm, adviser and business person who has provided feedback has recommended the OIO regime be reviewed and simplified because of the additional costs and delays being incurred. The taskforce notes that, given that the overwhelming majority of transactions are approved, these delays provide little or no benefit to New Zealand. While suggesting that the regime needs a fundamental review, the taskforce asks the relevant ministers to speed up the process to facilitate transactions where there are no sensitive issues.

Changes requiring further consideration

There are a number of changes the taskforce recommends for further analysis and urgent consideration. Briefly these are:

- **Eliminate the overuse of appraisal reports** which the Taskforce sees as often adding costs but not additional investor protection in circumstances where boards should make their own decision.
- **Increase the thresholds applicable to related party transactions** because of a concern that a threshold of 5% of Average Market Capitalisation is a burden for smaller-cap companies.
- **Considering a new "registered investors" exception to the non-public offers provisions in the Securities Act** allowing (with certain safeguards) persons to become "registered investors" who do not require the protection of the Securities Act disclosure regime.
- **Consider adding an addition exception equivalent to the Australian 20:12 rule** enabling companies to make offers to up to 20 people in any 12 month period up to a certain threshold (\$A2 million in Australia) without the need for a prospectus.

- **Amend the Securities Act to define investments in limited partnerships as equity investments** removing the need for a statutory supervisor.
- **Review the Securities Act and Securities Regulations to make disclosure in prospectus' more meaningful** removing unnecessary disclosures and costs.
- **Provide the Securities Commission with a retrospective exemption power** which is particularly relevant in the case of minor/technical breaches.
- **Remove the requirement that companies with 25% or more overseas ownership must file financial statements with the Companies Office.** This requirement in the Financial Reporting Act places such companies at a significant competitive disadvantage.
- **Tax changes.** The taskforce notes that there are a number of tax issues which it considers require urgent attention. However, it recognises the need for such changes to be considered within the context of overall taxation policy (which will be considered in the taskforce's final report).

Viewpoint

The taskforce should be applauded for the speed in which it has come up with a series of recommendations that address a number of impediments to capital-raising, particularly by listed issuers. The measures suggested are practical, conceptually sound and will significantly reduce the barriers to capital raisings by listed issuers.

As well as dealing with the problems that are being evidenced by the severe difficulties many businesses are encountering in seeking to access capital, the interim report also tackles a number of issues that have long been problematic with a Securities Act disclosure regime which has failed to keep up with developments in fund-raising activities. These problems are particularly evident in the case of listed issuers which are subject to continuous disclosure obligations. As a result, many of the recommendations are more in the nature of keeping up with developments in comparable markets rather than radical reforms.

The interim report also, quite rightly, asks whether a number of legislative provisions identified as impediments to fund-raising actually provide enhanced investor protection (and therefore whether investors would be disadvantaged by their removal). In our view, the changes suggested will not have this effect.

Finally, the taskforce recommendations appear to leave open a number of wider issues which, we expect, will be addressed in the further analysis that is called for in the interim report. When undertaking that analysis, we would hope that the CMD Taskforce, the Securities Commission and others not only address the needs of the 'big end of town' represented by listed issuers but also think about small and medium-sized enterprises, which contribute roughly 40 percent of New Zealand's GDP and which are also being badly affected by the contraction in the availability of credit.

To access a copy of the CMD Taskforce's "[Interim report on measures to combat financial crisis](#)" visit the Ministry of Economic Development's website: www.med.govt.nz.

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Securities and capital markets

Moratorium proposals: what do investors need to know?

In this article, partner Glenn Joblin discusses the level of disclosure which will be required for future issuers proposing a moratorium based on the experiences gained from the first round of moratorium proposals and a recent guidance note released by the Securities Commission.

In the second half of 2008 a number of high profile finance companies asked investors to approve moratorium proposals. In all cases, investors approved the proposals. However, whether investors were provided with sufficient information to make a meaningful comparison of the alternatives put before them has been questioned.

The Hanover Finance moratorium proposal, in particular, attracted a great deal of media attention, with some market commentators critical of the level of disclosure in relation to key aspects of the proposal. A "last minute" injunction application to postpone the investor meetings on the grounds that there was not sufficient disclosure in the moratorium documentation was unsuccessful.

At the same time, the Securities Commission, in response to the number of moratorium proposals being put to investors, issued a guidance note on the information that should be provided to investors in relation to such proposals.

What is a moratorium?

In simple terms, the finance companies' moratorium proposals provided investors with a choice between a moratorium (forgoing interest or principal repayments (or both) for a period of time) and a receivership.

A moratorium is intended to allow management to realise assets on an orderly basis. Most finance company plans promised interim repayments on specific dates, although some plans provided for payments to investors only when funds were available. The principal argument made in support of each moratorium proposal was that existing management is more likely to achieve a better return for investors than a receiver.

Moratorium proposal documents are subject to the disclosure requirements of the Securities Act 1978. In most cases, investors are provided with a notice of meeting accompanied by an independent expert's report. Depending on the terms of the proposal, a registered (often short form) prospectus is required (but not an investment statement).

Hanover Finance judgment

Much comment was made about the complexity of the Hanover Finance proposal and the perceived lack of information about key aspects of the proposal. One investor took the matter to the High Court and sought an interim injunction to postpone the investor meetings on the grounds that the lack of information in the materials sent to investors did not allow investors to make an informed decision.

The investor's argument centred on the injection of assets proposed from the transfer of Axis Property Group Holdings Ltd (a company associated with the ultimate owners of the Hanover Group) to the restructuring programme. It was submitted that the statements made in the investor documents regarding shareholder support to be provided to Hanover Finance were over-stated and put too absolutely. Furthermore, there was a failure on the part of Hanover Finance to provide adequate information to investors of the problems with realisation of the Axis assets, when compared with avenues of potential redress against directors or others involved in the company.

Hanover Finance argued that there was sufficient qualification in the reports relating to the Axis assets as the proposal made it clear that realising the \$40 million consideration attributed to the properties was dependent on prevailing market conditions at the relevant time. The court agreed with this argument, noting that it was "not convinced that the market values [of the properties], as at the present date, would necessarily change the approach of any particular investor to the decision that needs to be made at the meeting".

The court also expressed the view that this was not the type of case in which the court should intervene. In the court's view the nature of the motion before the investors was "quintessentially a commercial

judgement for individual investors to make", namely whether to accept what has been proposed to what might be available through other means.

Although sympathetic to the investors for the lack of time that they were given to consider fully their position, the court considered that it was an issue that could be addressed by the investors making a motion at the meeting seeking an adjournment under the terms of the debenture trust deed. By granting an interim injunction, the court would be removing the ability for investors to assess whether or not an adjournment was necessary, based on the information available to them.

At the meeting, no such request for an adjournment was made and the moratorium proposal was approved by Hanover Finance investors.

Guidance note from the Securities Commission

In early December 2008, the Securities Commission issued a guidance note to assist investors when reviewing moratorium documents. The Commission emphasised the need for investors to make a meaningful comparison between their options. While the total return may be likely to be less under a receivership, any returns will most likely come sooner than under a moratorium. Investors should look at the "net present value" of the amounts that are expected to be recovered under each option, as well as the expected total return. The Commission also points out that where payment is deferred under a moratorium proposal, investors are in effect being asked to take a further risk on the performance of the company's assets and management.

Investors should be told what assumptions about the future value of a company's assets have been made by its directors – and how those assumptions would stack up if applied under a receivership.

The Commission identified the following as key questions for investors to consider:

1. How would my rights be different under receivership?
2. How much am I likely to get under receivership, and when?
3. How much do the directors think I will get under a moratorium, and when?
4. Which is more in my interests, given my investment needs (including payout timeframes)?
5. What assumptions have the directors made if they say a moratorium will result in better returns? What are the risks compared with the risks of receivership?
6. Who would supervise a moratorium and report to the trustee or investors?
7. What is the plan to change the moratorium proposal if there are changes in the company's situation or economic conditions?
8. Do I get another chance to vote if things aren't going as expected?
9. Is there an independent expert's report and if so what does it say?
10. Have there been any independent valuations of assets?
11. If parties related to the company are contributing assets are there independent valuations?
12. What does the trustee have to say about the moratorium?
13. What are the financial and legal implications for the directors and other related parties under receivership compared with a moratorium?

What this means for future moratorium proposals

While we may have completed the round of moratorium proposals by finance companies, we are likely to see more moratorium proposals as other debt issuers seek to restructure their financing arrangements.

It is clear that the Securities Commission will monitor the level of disclosure in moratorium proposal documents. Issuers should ensure that their documentation enables investors to address the issues which have been identified by the Commission in its guidance note.

While the prescriptive disclosure requirements of the Securities Regulations will not necessarily require disclosure of all this information, the Commission's view is that investors need to be provided with additional information. The focus should be on a comparison of the alternatives facing investors.

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Securities and capital markets

Private placements to habitual investors: a recent case

The “habitual investor” exception provided by the Securities Act for private placements has been considered in a recent court decision involving offers of interests in a Queensland property development by companies controlled by property developer Dan McEwan. In this article, senior associate [Stephen Layburn](#) discusses some implications of this decision and notes some recent developments which may result in future improvements for New Zealand’s private placement regime.

The Securities Act distinguishes between public offerings and private placements. Public offerings must comply with disclosure, registration and other provisions whereas those not deemed as ordinary “members of the public” are regarded as capable of looking after themselves.

Unlike other comparable countries, New Zealand has relatively few safe harbours for private placements of securities made to “sophisticated” investors. One of the most commonly used (and possibly) misunderstood safe harbours is the “habitual investor” exception, which applies to offers made only to people whose principal business is investing money or who, in the course of and for the purposes of their business, habitually invest money.

The District Court two months ago found that property developer Dan McEwan and two companies controlled by him, collectively the McEwan Group, had offered securities to the public in breach of the Securities Act¹³. Judge Cunningham rejected the McEwan Group’s primary line of defence that the investors involved were “habitual investors” and therefore the offer of securities to them did not need to comply with the Securities Act’s disclosure (prospectus and investment statement) regime.

It started at a property seminar

As well as property development, the McEwan Group conducted property investment seminars. Seminar attendees who wanted to be classified as “habitual investors” and be eligible to join in McEwan Group investments, had to complete a detailed application form. The McEwan Group’s lawyers would consider the applicant’s investment background and decide whether they met the legal test of being a “habitual investor”.

The case against the McEwan Group originated at a Dunedin seminar where an attendee – the Investor – became interested in investing and went on to become a regional co-ordinator for the Group’s seminars and workshops.

The Investor completed an application form outlining his investment history over the last 10 years, which comprised involvement in several small businesses, a small forestry investment and rental property investments (four bought and two sold over four years). His initial application made on behalf of himself and his wife to be classed as an “habitual investor” was declined.

The Investor was unhappy about this and advised of additional investments (two further property developments), and by noting that he had a Master’s degree in commerce and stating that, surely the fact that he was involved with the McEwan Group counted for something. McEwan Group’s lawyers noted the impact of the additional investments and asked for confirmation that the activities were made jointly with his wife, which Mr Investor confirmed. As a result, The Investor was advised that the additional details he provided indicated that “you” qualify as habitual investors.

The Investor and his wife went on to make an investment of over \$100,000 in two projects in their joint names. Two years later, the Investor expressed his concern to the McEwan Group over his status as an habitual investor and explained that he did not see himself as qualifying having just read an article in a Securities Commission bulletin on the issue. The Securities Commission became involved and, ultimately, the Ministry of Economic Development took court action against the McEwan Group.

¹³ *Ministry of Economic Development v Stakeholder Finance Ltd, Agnes Water Acquisitions Ltd and Robert Daniel McEwan* (9 December 2008. Auckland DC CRI 2007-004-28150; CRI 2007-004-28160; CRI 2007-004-28102.)

The decision

Judge Cunningham concluded that property investing over four or five years described in the Investor's application did not meet the threshold test for a constant or continual activity required for the "habitual investor" definition. In fact it did not meet the criteria applied by the McEwan Group in seven investment decisions over a decade. The judge said as well as the number of investments, the period of investment was equally important and in this case four or five years was not sufficiently long to conclude that the Investor and his wife were in the business of investment.

Judge Cunningham said that it seemed "inevitable" that the nature of the investments and possibly the amounts involved also needed to be considered. She suggested that the success or otherwise of the investments could be another factor and that, in order to be an "habitual investor", the nature and quality of the investment history must come into the mix, noting that the Securities Act was investor protection legislation.

The judge also said an issuer or its directors should not simply delegate the task of determining who met the safe harbours to lawyers as the McEwan Group did - ultimately the issuer must be satisfied that investors qualified.

Commentary

The court has reaffirmed that the "habitual investor" exception has a very narrow application.

While each case will depend on the circumstances of individual investors, this decision offers rare guidance to issuers on the factors that are relevant to assess whether a person qualifies as a "habitual investor". It confirms that the onus is on the issuer, and not its advisers, to ensure that applicants claiming to fall within this exception are classified correctly. Issuers should have a robust screening process and apply it on a consistent basis.

The consequences if an issuer gets it wrong are serious. Not only will the investor be entitled to have his investment returned, the issuer (and its directors and principal officers) can face criminal liability under the Securities Act with a potential fine of up to \$300,000.

Recent developments and the way forward for private placements

The regulation of private placements in New Zealand has been recognised in the government appointed Capital Markets Development Taskforce (CMD Taskforce) interim report (released in November 2008) as an area which requires improvement in order to better enable small-scale private placements. Some of the taskforce's recommendations have already been addressed in the new Securities Disclosure and Financial Advisors Amendment Bill, introduced into Parliament on 18 February, which adds a new safe harbour exception in section 3(2) of the Securities Act¹⁴ and extends the application of the "eligible persons" regime in the Act.

These changes apply to both listed and unlisted issuers and will go some way towards addressing existing anomalies and providing more scope to facilitate private placements in the SME market – particularly for start-ups and "angel investors". (For further details on the CMD Taskforce recommendations and the Securities Disclosure and Financial Advisors Amendment Bill, see the following articles in this issue of Commercial Quarterly: ["Responding to the financial crisis: CMD Taskforce's interim report"](#) and ["Responding to the financial crisis: the Securities Disclosure and Financial Advisors Amendment Bill"](#).)

¹⁴ The effect of the amendment to section 3(2) is to provide that an offer of securities made only to persons who have previously paid a minimum subscription of at least \$500,000 for (initial) securities in a single transaction is not an offer of securities to the public to which the prospectus disclosure regime applies. However, there are some restrictions including that:

- the further securities offered must be identical to those initial securities; and
- the offer of further securities must be made within 12 months of the first allotment of the initial securities.

However, it is hoped that the promised 'root and branch' review of the Securities Act to commence later this year will provide a clearer delineation between offers made to those persons who do not need the protection of the Securities Act disclosure regime.

Bell Gully, in its discussions with the CMD Taskforce, has suggested private placements could also be significantly improved by adopting one or two of the principal safe harbours which are designed to facilitate private placements in Australia. In particular, many of the present uncertainties surrounding capital raising in the SME market and the question of who is an habitual investor could be removed by adopting the so-called '20/12' exception that enables companies to make offers of securities to up to 20 people in any 12-month in order to raise up to \$A2 million without a prospectus.

Securities and capital markets

NZX listed issuers should take note of a recent ASX reminder on continuous disclosure obligations surrounding periodic financial reporting

In its January 2009 Companies Update, ASX has provided further guidance to ASX listed issuers on their disclosure obligations in the period leading up to the deadline for lodging periodic reports for half-year or annual reporting periods where there is expected to be a material difference in the issuer's financial results.

Both the ASX and NZX listing rules contain continuous disclosure obligations which require issuers to keep the market fully informed in a timely way about material information relevant to the issuer. These are supplemented by separate Guidance Notes which set out the respective regulatory body's expectations in relation to best disclosure practice.

The ASX's Guidance Note 8 includes guidance to ASX listed issuers which is particularly relevant to their continuous disclosure obligations in the context of periodic financial reporting.

ASX's reminders on profit warnings and announcements of expected material differences in financial results

The key points made by the ASX in its latest update which may be of assistance to NZX issuers in their consideration of whether a matter requires disclosure under the NZX Listing Rules are:

- ASX listed issuers are required to make an appropriate announcement immediately they become aware that there is expected to be a material difference in the financial results for that period from the results that were recorded in the previous corresponding period, or from forecasts for that period that have been provided to the market by the issuer, or (in some cases) from analysts' consensus forecasts. The ASX does not consider that it is acceptable for the release of such information to be delayed until the release of the periodic financial report or until the release of the information has been considered by the board.
- As a general policy, a variation in excess of 10 to 15 percent may be considered material, and should be announced by the ASX listed issuer as soon as the issuer becomes aware of the variation. If the issuer has not made a forecast, a similar variation from the previous corresponding period will need to be disclosed. In certain circumstances a smaller variation will be disclosable.
- In making such disclosure, the ASX listed issuer must provide some details, however qualified, of the extent of the variation. For example a statement by an issuer may indicate that, based on internal management accounts, its expected net profit or EBIT will be an approximate amount (e.g. approximately \$6m) or alternatively within a stated range (e.g. between \$5m and \$7m). Alternatively, the issuer may indicate an approximate percentage movement (e.g. "up [or down] by 25%").
- In some cases, it may be appropriate for the ASX listed issuer to disclose material variations from analysts' consensus forecasts and expectations. This may occur where previous results do not provide the most relevant reference point or the market is moving in such a way as to indicate that there is a false market in an entity's securities. Officers of ASX listed issuers should refrain from publicly commenting they are "happy" or "comfortable" with analysts' consensus forecasts or a range of analysts' forecasts.

NZX's Continuous Disclosure Guidance Note

The equivalent NZX Guidance Note (issued in March 2005) also discusses the importance of disclosing a material change to prospective financial information, and sets out some examples similar to those outlined in ASX's Guidance Note. In particular it notes that:

- Disclosure would be required where the issuer, on reviewing management accounts part way through a half year period, becomes aware that revenues and profits for the period will vary from one or more of the following to a material extent:

- the financial results for the previous corresponding period;
 - prospective financial information such as forecasts or projections contained in any prospectus;
 - prospective financial information such as forecasts or projections previously provided to the market in relation to the half-year period.
- In making such disclosure, the entity must provide some details, however qualified, of the extent of the variation. For example a statement by an entity may indicate that based on internal management accounts, its expected net profit or EBIT will be an approximate amount (e.g. approximately \$10m) or alternatively within a stated range (e.g. between \$9m to \$11m). Alternatively, the entity may indicate an approximate percentage movement (e.g. “up [or down] by 25% on the previous corresponding period”). NZX accepts that this information may not be precise and may be changed or amended on completion of the final accounts. NZX does not require entities to make forecasts. The disclosure required would be limited to information known to the company – for example, close to or following the end of the reporting period.
 - Immediate disclosure would be required if two weeks prior to the due date for lodgement of a preliminary annual report an issuer’s year end adjustments and write downs will result in a significant reduction in the issuer’s result (even if the trading results for the issuer are broadly in line with the previous corresponding period). It is not appropriate for the issuer in these circumstances to delay the release of this information until the time of lodgement of the preliminary final report.

The question of when an issuer becomes “aware” of material information for the purposes of its continuous disclosure obligations is similar in both jurisdictions. The NZX Listing Rules state that an issuer becomes “aware of information if a Director or an executive officer of the issuer (and in the case of a Managed Fund, a Director or executive officer of the Manager) has come into possession of the information in the course of the performance of his or her duties as a Director or executive officer.”

Commentary

In New Zealand, a breach of the continuous disclosure rules can result in a fine or other penalty imposed by NZX Discipline on the issuer under the NZX Listing Rules. The continuous disclosure rules are backed up by the Securities Markets Act 1988 (SMA) which provides liabilities for non-compliance with the NZX Listing Rules and enforcement mechanisms for the Securities Commission.

Since an amendment to the SMA in early 2008, a breach of the continuous disclosure rules can also result in personal liability for the directors or senior management of the company. Liability under the SMA now extends to all persons “in any way, directly or indirectly, knowingly concerned in, or a party to, the contravention by any other person”. The Securities Commission has expressed the view that this is intended to allow it (or shareholders) to bring proceedings against the directors of a company which fails to comply with its continuous disclosure obligations.

This liability under the SMA can take the form of a liability to pay compensation to shareholders who have suffered loss by the non-disclosure (such as those who acquire securities at a time when price-negative information is not announced) and/or a pecuniary penalty of up to \$1 million.

We believe that NZX and the Securities Commission are likely to be particularly vigilant about inquiring into possible continuous disclosure breaches in respect of unexpected financial results. A focus by regulators on continuous disclosure is heightened where a listed company’s share price falls sharply. In those circumstances the issue will be addressed with the benefit of hindsight and the non-disclosure of matters which have subsequently contributed to a significant loss of shareholder value can be difficult to justify. This therefore represents one of the major areas of risk for issuers and their directors.

To access a copy of ASX’s January Company Update visit the ASX’s website at www.asx.com.au

If you would like to discuss any aspect of this update, please contact any of the Bell Gully team listed below.

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Securities and capital markets

Updated guide on the trans-Tasman mutual recognition scheme for offers of securities

The Securities Commission and the Australian Securities and Investments Commission (ASIC) have released a new version of their joint guide on the trans-Tasman mutual recognition scheme for offers of securities.

Background

In June 2008, Australia and New Zealand exchanged diplomatic notes to bring into effect the trans-Tasman Mutual Recognition of Securities Offerings scheme (mutual recognition scheme).

The mutual recognition scheme permits an Australian issuer to extend an offer regulated under Australian law into New Zealand using the disclosure document required under Australian law, subject to meeting certain conditions. This means that an Australian issuer is no longer required to prepare an investment statement to wrap around the Australian disclosure document. The laws implementing the mutual recognition scheme in New Zealand are set out in Part 5 of the New Zealand Securities Act and the Securities (Mutual Recognition of Securities Offerings – Australia) Regulations 2008.

On the other side of the Tasman, the mutual recognition scheme permits a New Zealand issuer to extend an offer regulated under New Zealand securities laws into Australia using only the offer document required under New Zealand law, subject to meeting certain conditions. No separate Australian offer document is required. The laws implementing the mutual recognition scheme in Australia are set out in Chapter 8 of the Australian Corporations Act and the Corporations Amendment Regulations 2008 (No.2).

Updated guide

The Australian Securities and Investments Commission (ASIC) and the Securities Commission released an updated joint guide on the mutual recognition scheme on 21 January 2009. This replaces the original guide issued when the scheme was introduced in June 2008.

The main change of note in the updated guide is the additional notification requirements for an issuer which arise when an issuer is required to notify the relevant overseas regulatory body of its intention to make an offer under the mutual recognition scheme.

In accordance with the updated guide, if a New Zealand issuer proposes to make an offer of securities in Australia, the New Zealand issuer must now lodge with the New Zealand Companies Office (NZCO) written notice of its intention to make the offer under the mutual recognition scheme no later than the time it is required to notify ASIC of its intention to do so.

Similarly, if an Australian issuer proposes to make an offer of securities in New Zealand, the Australian issuer now must lodge with ASIC written notice of its intention to make the offer under the mutual recognition scheme no later than the time the NZCO is notified of the Australian issuer's intention.

To access a copy of the updated guide visit the Securities Commission's website at www.seccom.govt.nz or [click here](#).

Securities and capital markets

Director loses appeal over false offer document

The director of a Dunedin-based company failed to get his convictions and sentences dismissed in relation to an advertisement on the internet offering securities to the public containing untrue statements.

The director challenged both the convictions and sentences imposed on grounds which included the following:

- that the security involved was not a “debt security” rather a “participatory security” of which Global FX Secure Pte Limited (Global FX) was not the “issuer”; and
- that Global FX did not have a “principal place of business in New Zealand” and, accordingly, section 58 of the Securities Act 1978 (Securities Act) did not apply in the circumstances of this case.

Background

This case¹⁵ concerned advertisements for investments in the Global FX Secure Trust II (Trust). The investments were offered by Global FX Secure Pte Limited, a company incorporated in Singapore, as trustee of the Trust (Global FX). The director and shareholder of Global FX was WKF Asset Management Limited, a Dunedin based company, whose shareholders and directors included the appellant.

The appellant was convicted in the District Court for three charges of being a director of a company which issued securities to the public and distributed advertisements containing untrue statements (namely, that well known international firms acted as brokers for the Trust) contrary to section 58(1) of the Securities Act. A fine of \$7000 was imposed on each charge.

Court’s decision

In dismissing the appeal, the High Court held that:

- Regardless of whether the investment was characterised as a debt security or a participatory security, Global FX was the issuer of the advertisement. Under the Securities Act, the definition of “issuer” varies between the different types of security – in relation to a debt security the issuer is “the person on whose behalf any money paid in consideration of the allotment of the security is received” and in relation to a participatory security the issuer means “the manager”. In this case, if the security involved was a debt security, it was clear from the terms of the trust deed that Global FX received the money both physically and in substance, albeit in its capacity as trustee. However, if the investment was a participatory security, Global FX remained the issuer (as the person on whose behalf the money invested is received is deemed to be the manager).
- Although Global FX was a Singapore registered company it had no business activities in Singapore. Global FX’s functions as trustee to the Trust were performed by WKF Asset Management Limited, the directors of which operated out of Dunedin and utilised a bank account in Dunedin. Dunedin was therefore held to be Global FX’s principal place of business and accordingly the conduct fell within the territorial scope of the Securities Act.

For an explanation of the regime for the regulation of misleading and deceptive conduct in respect of securities following the 2006 amendments to New Zealand’s securities legislation please refer to the article ["The new securities law regime for misleading and deceptive conduct"](#) in the Spring 2008 issue of Commercial Quarterly.

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¹⁵ *Nicolaas Jan Carel Francken v. Ministry of Economic Development* (1 December 2008, Panckhurst J, HC Dunedin CRI 2008-412-000025)

Competition and consumer law

Commerce Commission seeks views on applying new price control law

The Commerce Commission has started 2009 with a full book of reviews that will shape its approach to the regulation of some of New Zealand's key industries. In this article, senior associate David Blacktop reviews the Commerce Commission's discussion paper setting out its preliminary views on the implications of the recent rewrite of New Zealand's price control legislation which passed into law in October 2008.

Recent trends in the Commerce Commission's approach to mergers

Recent developments have affected how the Commerce Commission will assess clearance applications for mergers and acquisitions. In this update, partner Torrin Crowther summarises recent trends and looks at the impacts for businesses seeking Commission clearance.

Language in documents: Competition law issues

Avoiding the perception of a competition law breach can prevent a great deal of wasted time and money defending the firm against allegations of wrongdoing. In this article, partner Torrin Crowther outlines some guidelines for avoiding the language trap.

Competition and consumer law

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Released just before Christmas, the discussion paper raises a number of important questions.

Those that hoped that the rewrite of the price control legislation would cause a fundamental change in the Commission's approach to regulation might well be disappointed by its 159-page discussion document.

This is perhaps not that surprising. After all, as the American Economist John Kenneth Galbraith said: "Faced with the choice between changing one's mind and proving that there is no need to do so, almost everyone gets busy on the proof."

While the Commission has yet to make the decisions that will shape the regulatory framework, for those that have previously taken a different approach to the Commission, a response to the discussion paper now may present the best time to influence the Commission's thinking.

What is hoped for from the rewrite of the price control legislation?

The rewrite of the price control legislation was enacted relatively quickly by New Zealand standards. One of the key drivers for the speed with which the changes were made appeared to be the Government's concern at the controversy resulting from the Commission's decisions to publish an intention to declare control of Vector's electricity lines businesses and Transpower's transmission pricing. These decisions were roundly criticised by many businesses, both regulated and unregulated, which were frustrated that both the regime and the Commission's approach provided little certainty and little incentive to make investments.

The new regime is designed (and is hoped) to improve certainty and clarity for businesses and to provide greater incentives for future investment.

The new regime has improved the regulatory processes and this should mean more certainty and clarity for businesses from a process perspective.

For example, the requirement for the Commission to publish binding input methodologies and the introduction of the potential for customised price quality thresholds for firms with particular circumstances, such as a need for extensive capital investments, are definite process improvements.

Will the rewrite of the price control law cause the Commission to change its approach?

While there are real improvements to regulatory processes, those hoping the new regime would cause a dichotomy shift in the Commission's approach in implementing regulation may well be disappointed. Indeed, the discussion paper leaves the reader with the distinct impression that the Commission's application of its regulatory agenda will be unlikely to change significantly. This is hardly surprising – the Commission's membership has not changed and the Commission has publicly paraded its success in achieving what it considers to be improved outcomes for New Zealand consumers.

An illustration of the Commission's unchanged stance is its discussion of the new purpose statement. The new purpose statement essentially builds on the purpose statement that previously applied only to Electricity Lines Businesses (ELBs).

The introductory words of the new statement include the same overarching goal as was included in the ELB purpose statement i.e. regulation is "to promote the long-term benefit of consumers".

The previous statement had three sub-paragraphs detailing the specific factors the Commission had to consider when applying its powers for this overarching purpose. The new purpose statement adds a fourth: that regulated business have incentives to innovate and to invest, including in replacement, upgraded, and new assets.

While this change seemingly elevates the importance of investment, the Commission does not seem to view this as a fundamental change requiring it to modify the emphasis on the factors it considers. The discussion paper notes the High Court's interpretation of the previous statement:

"The Court also noted that subsections (a) to (c) "are identified by Parliament as central aspects of the long-term interests of consumers **and are central, though not exclusive, goals for the Commission in the performance of its duties** under subpart 1 of Part 4A." This serves as a useful guide to interpreting the new purpose statement in section 52A." (Emphasis added)

It also notes the Commerce Select Committee's statement that although "incentives to invest are important, we consider they need to be balanced against the need to protect consumers from excessive prices", and, perhaps more tellingly, notes that "...in the context of performing its regulatory functions prior to the introduction of the [amendments], it considered the promotion of dynamic efficiency to already be implicit in section 57E(b)... and in section 70A(c) of the Act..., as well as in the 2006 GPS..). This is because the Commission considers that in each case the reference to efficiency relates to all three efficiency dimensions".

These statements serve to illustrate that the Commission does not see the addition of investment into the purpose statement as requiring it to change its approach. Rather the addition simply makes an existing consideration explicit.

Is responding to the discussion paper important?

The purpose statement example is symptomatic of the view implicitly expressed in the discussion paper that the changes to the legislation will not require the Commission to change its approach.

This is important because while key decisions on input methodologies and the way in which regulation will be imposed have yet to be made, the discussion paper cannot be regarded as solely a process paper – indeed it raises many fundamental questions that will shape the way in which the subsequent decisions about input methodologies and the various regimes are implemented.

For example, the questions posed concern:

- the way in which the regulatory asset base should be valued;
- the way in which tax and depreciation should be treated;
- the continued use of NPV=0 and Financial Capital Maintenance concepts;
- the way in which common costs are allocated;
- whether PO adjustments should be made;
- how the "claw back" provisions should be applied;
- what factors should be considered in setting information disclosure requirements;
- whether X factors should be set taking into account overseas benchmark productivity information;
- can an index other than CPI be used in the price path thresholds; and
- how prescriptive information disclosure requirements should be.

For regulated businesses especially, while the process changes will no doubt improve outcomes, if they disagree with the Commission's previous regulatory approaches, then the discussion paper intimates that there is still work to be done. While it might be tempting to wait until specific discussion papers on input methodologies etc are published to fully respond to the Commission's views, it may be that the time to move is now because influencing the Commission's thinking at an early stage may be easier and more effective.

For a copy of the discussion paper visit the Commerce Commission's website at www.comcom.govt.nz
Submissions closed on 16 February 2009.

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Competition and consumer law

Recent trends in the Commerce Commission's approach to mergers

Recent developments have affected how the Commerce Commission will assess clearance applications for mergers and acquisitions. In this update, partner Torrin Crowther summarises recent trends and looks at the impacts for businesses seeking Commission clearance.

The "Failing Firm" argument

In certain circumstances, the Commission will clear a merger on the basis the target business is a "failing firm" – even where very high market shares (or sometimes even a monopoly) will result. Historically, the failing firm test has been extremely difficult to meet, given the Commission needs to be "satisfied" the business will fail, there are no alternative buyers and the target's assets will not otherwise constrain the applicant.

While there have only been a handful of successful failing firm applications since the 1990s, the current economic climate suggests that we may see more in the short term. A recent example was the Commission's clearance for Fletcher Building to acquire certain masonry assets from Stevenson Group, on the basis there was no real prospect of a third party acquiring the business as a going concern, or acquiring the assets on closure and using them to compete in the relevant markets. (Bell Gully acted for Stevenson in successfully advancing that failing firm argument.)

Inevitably, such failing firm arguments are led by the target, not the applicant. Firms contemplating a failing firm argument should be prepared to provide the Commission with:

- evidence of previous attempts to restructure;
- details of the sales process undertaken and the nature of the bids received; and
- the firm's assessment of those bids and its liquidation benefits,

as well as associated management reports, board papers and board minutes.

While the failing firm hurdle is relatively high, it is important to realise that it is not necessary to show that there are no alternative bids for the business or assets, but rather that there are no alternative bidders that will pay more than the close-down/liquidation benefits to the firm. Such benefits typically accrue from scrapping the assets, putting the assets to alternative use or selling the assets off-shore.

Commission's approach to testing the parties' arguments

The Commission is increasingly demanding hard, factual evidence before it accepts assertions from the parties. As we've signalled in the past, the Commission is putting increasing weight on internal company documents (such as board papers, management reports, etc.) as part of its assessment of clearance applications, and will almost always request such internal documents during the clearance process. Likewise, such documents can often be presented by the applicant (or the target) in support of their own arguments for clearance.

It's therefore essential that the language used in these internal documents is clear and unambiguous. (To read Bell Gully's Language in Documents guidelines refer to the article "Language in documents: Competition law issues" also in this issue of Commercial Quarterly.) An important point in the merger context is to make sure that management papers/presentations do not exaggerate a merger's potential to lead to price or margin increases, where such increases are unlikely.

Revised merger process

The Commission's recent Mergers and Acquisitions Clearance Process Guidelines provide greater transparency by formalising the Commission's approach to assessing clearance applications. The guidelines include a reference to pre-notification discussions and a statement of preliminary issues.

Pre-notification discussions give a potential applicant the opportunity to engage with the Commission on a more informal level before an application is actually filed. While the guidelines formalise this initial step in the clearance process (and are therefore welcomed), at a practical level there is little change because there has always been the scope for such discussions.

The Commission aims to publish a Statement of Preliminary Issues within 15 working days of the application's registration, outlining the potential competition issues raised by the application. The Commission has said the statement's purpose is to improve the transparency of the clearance process and to enable interested parties to make submissions on issues identified by the Commission. While this may be valuable to third parties, we see only very limited benefit to the merging parties themselves. They will already be aware of those issues, and in fact the process of preparing the statement risks diverting the Commission's resources away from the actual investigation.

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Competition and consumer law

Language in documents: Competition law issues

Avoiding the perception of a competition law breach can prevent a great deal of wasted time and money defending the firm against allegations of wrongdoing. In this article partner [Torrin Crowther](#) outlines some guidelines to help you avoid the language trap.

Unfortunate language has a strange habit of eventually coming to light – clear and unambiguous language will go a long way to avoiding an issue in the first place.

The use of language is particularly important given the ever-increasing use of email to communicate both internally and externally. Emails often contain informal language, include throw-away comments and tend to become widespread very quickly as they are forwarded on to individuals and whole email groups – increasing the risk that today's recipient is tomorrow's disgruntled ex-employee!

Guidelines

Adhering to the following guidelines will go a long way to avoiding unnecessary investigations.

- Ensure the intent of documents is clear. For example:
 - If you are seeking support from colleagues to reduce price to maintain market share, say, "we need to reduce price to remain competitive", rather than, "let's reduce price to send a message they shouldn't try and take us on".
 - Similarly, if a supplier's sales staff are instructed to discuss recommended resale prices with their retailers, say, "explain to retailers why we think our recommended resale price is appropriate", rather than, "get them to accept our recommended resale price".
- Stick to the facts. Avoid conjecture, exaggeration and emotive words such as "squeezing", "crushing", "taking out", "dominate", "own the market", etc.
- Refer to customers as having been "lost", rather than "stolen". Aggressive price cutting should not be characterised as "unethical" or price leaders described as "mavericks".
- Express why you think a proposed course of action is appropriate, i.e. "We'll have the most sought after deal in town upon implementation".
- Provide a proper context for comments that may otherwise raise a red flag. If a management report includes post-merger price increases as a sensitivity test, ensure they are clearly stated as such and explain how they have been created.
- Do not use phrases such as "rational pricing", "stabilise pricing", etc. as these can often be interpreted as one firm attempting to signal to a competitor (perhaps via a third party) to raise price or reduce discounts.
- Do not overstate the significance of a position or course of conduct by using phrases such as, "we'll own the whole market if we stick to our guns on this one" or, "this could be the final nail in the coffin for firm A".
- Do not "guild the lily" in management papers/presentations about a merger's potential to lead to price or margin increases where such increases are unlikely.

The golden rule is to ask yourself if you'd be happy for your message to end up on the front page of tomorrow's newspaper.

Intellectual property and information technology

Keeping spam in the can: the Unsolicited Electronic Messages Act 2007

It is estimated that more than 100 billion spam emails are sent every day throughout the world. The Unsolicited Electronic Messages Act 2007 was introduced to reduce spam in New Zealand. Now that the Act is over a year old, solicitors Jessie Parker and Nick Laing ask the inevitable question: is there any cause for celebration?

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History

The Unsolicited Electronic Messages Act 2007 (the Act) follows similar anti-spam laws adopted in Australia and the United Kingdom which prescribe an "opt-in" regime. The opt-in regime starts with the presumption that unwanted electronic messages are spam unless the sender can show that the recipient consented to receiving them. The alternative approach is the "opt-out" regime which requires the recipient to notify the sender that its messages are unwelcome. By adopting the opt-in approach, New Zealand has taken a firm stance against spamming. The reality is that for the relatively small number of businesses in New Zealand that generate sales through sending emails, non-compliance with the Act could potentially be very costly.

Key provisions

The Act prohibits the sending of unsolicited commercial electronic messages. Electronic messages include emails and SMS text messages, but not faxes.

An electronic message is "commercial" if it:

- promotes or markets goods, services, land or a business or investment opportunity;
- assists a person to obtain a dishonest financial advantage from another person; or
- provides a link, or directs a recipient to, information that does one or more of the above things.

There are certain exceptions to this. For example, messages that provide a quote requested by the recipient or complete a transaction that the recipient has agreed to are not commercial messages for the purposes of the Act.

Any commercial electronic message will be "unsolicited" unless it:

- is sent with the consent of the recipient – consent may be express, deemed or inferred;
- contains a functional unsubscribe facility; and
- clearly identifies the sender.

The Act also prohibits the use of address harvesting software (i.e., software that trawls the internet, collects and indexes email and other electronic addresses) with the intention of sending unsolicited commercial electronic messages.

Any cause for celebration?

One year on, it is interesting to consider some of the lesser known provisions of the Act:

- the application of the Act to organisations outside of New Zealand;
- the deemed authorisation provisions; and
- enforcement issues, in particular the civil proceedings that were commenced in the High Court in December last year.

Organisations outside New Zealand

Section 8 of the Act provides that the Act extends to “relevant persons” who engage in conduct outside New Zealand to the extent that such conduct results in an unsolicited commercial electronic message being sent in New Zealand. The definition of “relevant person” includes “an organisation that carries on business or activities in New Zealand”. This wording is without statutory equivalent.

Many of us are familiar with the reference to “carrying on business in New Zealand” in section 332 of the Companies Act 1993. However, the reference to “activities” arguably extends the application of the Act further than the Companies Act 1993. It is likely this was intentional so as to capture all spam-related activities. Arguably any organisation that solicits business in New Zealand via unsolicited commercial electronic messages would be caught by section 8 of the Act.

Deemed authorisation

Section 17 of the Act contains a deemed authorisation provision. It provides that where person A sends an electronic message on behalf of person B, person B is deemed to have authorised the sending of the message. This is particularly relevant where a company (person B) employs an agent or another company (person A) to send, for example, marketing or promotional messages on its behalf.

Issues may arise where the contract between person A and person B does not closely define the scope of the authorisation. Subsection 17(2) of the Act provides that person A only sends a message on behalf of person B if person A has the authority to do so. The Act does not clearly specify what constitutes authority. If an agreement provides that person A is authorised to market person B’s products electronically, has person B authorised person A to send spam?

It should be made clear in contracts for the provision of electronic marketing services that the scope of the services does not extend to sending unsolicited commercial electronic messages in breach of the Act. It may be sufficient for the contract to include a provision requiring person A to comply with all relevant laws in providing the services.

Enforcement

The New Zealand Department of Internal Affairs (DIA) is responsible for enforcing the Act. The DIA has stated that its focus in enforcing the legislation will initially be on assisting companies to comply with the Act, rather than taking a punitive approach. However, in December 2007 the DIA raided four properties in Christchurch and seized 22 computers in connection with a large international spamming operation. The DIA commenced High Court proceedings against three of the spammers, seeking payment of a pecuniary penalty for breaches of the Act.

In *Chief Executive, Department of Internal Affairs v Atkinson*¹⁶ the first penalty was imposed under the Act. Due to the large-scale of the spamming operation and its impact on New Zealand, the court held that the starting point for the penalty should be the maximum amount of \$200,000. It was noted that the deterrent effect of a penalty would be lost if the penalty only marginally increased the cost of the illegal activity. However the court considered that the second defendant was entitled to a substantial discount because:

- the spamming began before it was illegal to do so (although it continued after the Act was in force); and
- the second defendant had cooperated with the DIA and had given an undertaking in relation to future compliance with the Act (which is enforceable under section 34 of the Act).

The High Court therefore ordered the second defendant to pay \$100,000. The case is continuing against the first and third defendants, who have contested the allegations that they breached the Act.

Recently the Federal Court in Perth awarded a financial penalty of \$4.5 million against a company and \$1 million against its managing director for multiple breaches of Australia’s Spam Act 2003. In New Zealand, such large damages amounts are not contemplated under the Act which provides for court-ordered penalties of up to \$200,000 for an individual or \$500,000 for an organisation.

¹⁶ (High Court, Christchurch, 19 December 2008)

Utilities and resources

New approach for dry winters: report calls for power companies to pay for their own mistakes

The Electricity Commission has released the Review of Winter 2008 report for consultation by stakeholders before it formally considers the report's eight recommendations on how the market could be improved to better manage dry winters and improve future performance. In this article, Bell Gully partner Garry Downs and summer clerk Ryan Manton provide an overview of these recommendations and the report's findings.

Changes to the Government Policy Statement on Electricity Governance – the first step in the National Party's reform of the electricity industry

On 2 March 2009, the Government released for consultation a revised policy direction for the Electricity Commission. In this update, senior associate Louise Hill outlines the key changes proposed for the new Government Policy Statement on Electricity Governance.

Labour's ETS still in place but undergoing comprehensive review

In this article, senior associate Kate Radka provides an update on the Emissions Trading Scheme and the current review of the scheme by a special select committee established at the end of 2008.

Draft Forestry Allocation Plan and the need for pre-1990 foresters to act by mid-2009

The forestry aspects of New Zealand's emissions trading scheme became effective on 1 January 2008 and remain in force. In this article, senior associate Kate Radka provides an outline of the Draft Forestry Allocation Plan (which is currently under consultation) for the allocation of pre-1990 forests and the potential exemptions for such forests under the emissions trading scheme.

Utilities and resources

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Introduction

The lead up to the winter of 2008 saw national hydro lake inflows between early November 2007 and mid-June 2008 the lowest on record since 1931. Hydro storage fell below the minzone¹⁷ level for the first time ever and began to approach the emergency zone¹⁸ before inflows and storage recovered. The situation was magnified by the unexpected withdrawal from service of Pole 1 of the HVDC link, which constrained the transmission between the North Island and South Island.

Although forced power cuts were not required, the Review of 2008 Winter, undertaken by energy sector consultant David Hunt, company director John Isles and project manager Megan McKenna, was initiated by the Electricity Commission (the Commission) to assess the experience of dry year risk management with respect to the winter of 2008, and to identify options to improve the energy security policy framework.

The report, *Review of 2008 Winter*, was released by the Electricity Commission on 21 January 2009, without comment by the Commission, to ascertain industry participants' points of view about the work that should be initiated as a result. This initial consultation closed on 20 February 2009, but the Commission has stated that comprehensive submissions will be sought on specific policy or rule changes in the usual way later this year.

The report provides an overview of the 2008 winter events and sets out eight recommendations for the direction of future work.

Major issues

Despite the stress the electricity market was placed under, the report notes that there were many positives to draw from the winter of 2008, including the relatively high degree of hedging by customers as 'insurance' against dry events, improved information availability, and strong efforts to increase non-hydro supply and to conserve electricity. However, the recommendations arising from the review are based on the observation that some of the decisions made by market participants and the Commission during the 2008 winter were not optimal as far as security of supply was concerned.

Lack of thermal energy use to conserve hydro storage

During the period when storage was below the minzone, the reviewers found that there were times when additional thermal energy was available to conserve hydro storage but was not used. This was despite the Commission's published security of supply policy, which at the time contained an express expectation that non-hydro generation would run to the maximum feasible extent to meet a 1 in 60 dry year standard if storage had fallen below the minzone level. Moreover, the report describes that instead of drawing on such thermal energy, some discretionary hydro releases occurred when storage was approaching the minzone which increased the risk of shortage.

The report stated the Commission had an obligation to take reasonable endeavours to ensure security of supply in a 1 in 60 dry year¹⁹. The primary mechanism of ensuring security is the procurement of reserve energy. In the winter of 2008, to achieve this security and to conserve hydro storage, the Commission

¹⁷ The Electricity Commission's estimate of the minimum hydro storage requirement during the year for the system to be able to meet expected demand (without emergency measures), should a 1 in 60 year hydro drought occur from that point forward.

¹⁸ The point at which the risk of shortage was assessed as a 1 in 10 chance.

¹⁹ As a result of the Government Policy Statement on Electricity Governance released in May 2008, the "1 in 60" dry year standard was replaced by a standard expressed in terms of "winter energy margin", which is the margin between forecast capacity to supply in a mean hydro year and forecast demand.

procured reserve energy from the Crown-owned station at Whirinaki. It also decided to hold the Whirinaki offer price at \$289/MWh, despite rising fuel costs, to decrease the incentive for further hydro releases. Excess costs were recovered by a uniform levy on all wholesale purchasers. This fixed offer price also placed downward pressure on spot prices.

No incentives to use thermal energy

The key issue arising from the decisions taken by the Commission during this period was that they highlighted problems with the nature of the incentives created under the current regime.

The reviewers found that generators were willing to forgo additional thermal output in favour of drawing on hydro storage because of the perception that more hydro storage would become available (e.g. by re-enacting legislation to allow use of additional storage at Lake Pukaki). The risk of a shortage was therefore seen as a distant one. The report stresses that recovering excess costs incurred by the Whirinaki station from a uniform levy did not distinguish between those who prudently managed their risks and those who did not. It quotes one major user complaining that "[w]e were asked to be prudent, we were prudent, and now we have to pay for others' imprudence". The report further notes that keeping the price low, as opposed to the high spot prices that would usually reflect tight supply, also reduced incentives to take other actions to avoid a shortage such as conserving storage, reducing discretionary demand, and long-term investment in new plants.

Costs borne by affected consumers

Another problem identified in the report is that the cost of any forced power cuts would be borne by affected consumers rather than the parties that contributed to the shortage such as over-committed suppliers or under-insured consumers. It notes that demand curtailment is likely to reduce spot prices thereby affording relief in the spot market to suppliers. As a result, demand curtailment may be seen as a low cost option by suppliers.

Uncertainty over Commission's response

The reviewers found that, in an attempt to decrease market participants' reliance on reserve measures, the Commission had delayed reserve actions for as long as possible and not communicated when such measures would be implemented. This led to uncertainty for many parties, especially around expectations on potential demand buybacks. There was also a considerable degree of uncertainty surrounding access to emergency resources such as Lake Pukaki and Lake Hawea.

Recommendations

The above issues evidence a friction between the roles of market participants and the Commission when it comes to reserve supply. The report's recommendations are framed around the view that security robustness would be best achieved through the actions of individual participants rather than the active intervention of the Commission. This would see the Commission removed as the de-facto "supplier of last resort" and, instead, allow the system to adopt a more market-based approach which would depend on suppliers and users acting prudently, and the Commission retaining a clear monitoring and regulatory role.

The reviewers' eight recommendations outlined in the report are set out below.

(1) Target costs at electricity companies benefiting from reserve energy or implement compulsory dry year insurance

Under a market-based approach participants would be required to pay for their own mistakes. In order to reduce opportunities for shifting costs, the present reserve energy scheme should either be discontinued or modified to ensure costs are targeted as closely as possible to those parties who benefit from its use. This could be achieved if the full cost of reserve energy measures were recovered via spot prices as far as possible. This would decrease the scope for cost shifting because participants with net exposure to spot prices would bear the cost via the wholesale market.

Market rules should also be changed to ensure decision-makers bear the cost to consumers of any forced demand curtailment. This could be achieved by ensuring that spot prices during any curtailment reflect the cost of non-supply, thereby reducing the incentive for suppliers to treat demand curtailment as a low cost option.

As an alternative, a compulsory dry year insurance scheme should be adopted, although the incentive-based approach is preferable because it would have a shorter lead time for implementation and should be able to deliver similar benefits but at a lower cost.

(2) Review the Commission's emergency diesel fired Whirinaki plant

Analysis should be undertaken to determine whether the three 52 MW units at Whirinaki could be relocated or their fuel choice converted to dual gas/diesel firing to provide a greater and more cost-effective contribution to New Zealand's supply. However, should such relocation or fuel modification be desirable, then the units ought to be transferred out of the reserve energy scheme so as not to render them less credible as a last resort plan, since there would be stronger pressure to use the plant earlier. This would enable the units to make the fullest contribution to supply in New Zealand.

(3) Define and publish plans for emergency measures during a dry year

Triggers and plans for any emergency measures should be pre-defined as far as practicable, and that they should be published. This recommendation is based on the reasoning that if the above recommendations were carried out so that participants would be less able to shift their costs, then there would be less scope for participants to rely on the Commission acting pursuant to clear triggers and plans.

(4) Formalise improvements made in 2008

Examination should take place into whether the improved information provision by the Commission that took place during the 2008 winter should be codified into existing arrangements or contingency plans.

(5) Improve risk disclosure

Major sellers of electricity contracts should be required to provide regular disclosures regarding their risk position in light of their forward sales commitments and their ability to meet those commitments.

(6) Provide certainty over Commission's role

The Commission should consider whether it can take any steps to provide more certainty around the terms of resource consent access to emergency generation resources.

(7) Clarify the roles of the Minister and the Commission

The respective roles of the Minister of Energy and the Commission regarding the security of supply should be clarified, and the Commission be given a greater degree of independence in the exercise of its regulatory functions.

(8) Prioritise initiatives that facilitate competition

To allay concerns that the proposed changes will place upward pressure on electricity costs, the Commission should place priority on initiatives that will facilitate competition.

Government Policy Statement (May 2008)

The report notes that none of the eight recommendations are affected by the Government Policy Statement (GPS) issued in May 2008, and the subsequent changes made by the Commission to its security of supply policies to reflect the new GPS. This is because the key changes arising from the GPS (namely the replacement of the 1 in 60 dry year standard with a 'winter energy margin' and the replacement of the minzone and emergency zone concepts with a set of 'hydro storage guidelines') do not address the underlying incentive issues which formed the major part of the review. (For details on the GPS please refer to the article ["More regulatory policy initiatives in the electricity market"](#) in the Winter 2008 issue of Commercial Quarterly.)

The National government's proposed revised policy direction for the Electricity Commission set out in a new draft Government Policy Statement (released on 2 March 2009) reinforces that none of the eight recommendations are affected by the GPS. However, there is a notable emphasis on the priority the government accords to security of supply policy by bringing this section forward in the new draft Government Policy Statement. If adopted, it is unlikely this new Government Policy Statement (which is currently the subject of public consultation until 16 March) will affect which recommendations that are adopted by the Commission. (See the article ["Changes to the Government Policy Statement on Electricity Governance – the first step in the National Party's reform of the electricity industry"](#) in this issue of Commercial Quarterly for further details.)

Commentary on Winter Report

Early indications from the Commission suggest that it generally sees the report as favourable and that it intends to adopt some of the simpler recommendations in time for the 2009 winter. However, the implementation of the more significant recommendations will depend on a number of other factors, including the responses the Commission receives from its initial round of consultation, which closed on 20 February. Clearly, much will also depend on the final form of the new government's draft Government Policy Statement for the Commission and ultimately how the new government proceeds with its proposed review of the electricity sector. The Minister for Energy and Resources Gerry Brownlee has recently confirmed that the government intends to review the roles of the Electricity Commission, the Commerce Commission and Transpower with the goal of eliminating unnecessary role duplication. One possible outcome of this review may be the disestablishment of the Electricity Commission which would obviously render many of the recommendations in the report redundant.

We will keep you updated with any further developments.

To access a copy of the Review of 2008 Winter report visit the Electricity Commission's website at <http://www.electricitycommission.govt.nz/consultation/winter08>.

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Utilities and resources

Changes to the Government Policy Statement on Electricity Governance – the first step in the National Party's reform of the electricity industry

On 2 March 2009, the Government released for consultation a revised policy direction for the Electricity Commission. In this update, senior associate [Louise Hill](#) outlines the key changes proposed for the new Government Policy Statement on Electricity Governance.

Introduction

The interaction of the many regulatory and policy documents in the electricity sector, together with the overlap of the roles of the regulators in this sector have come under scrutiny lately. As noted in our article "[More regulatory policy initiatives in the electricity market](#)" in the Winter 2008 Commercial Quarterly, there are many regulators in this industry, including the Electricity Commission, the Commerce Commission and the Energy Efficiency and Conservation Commission. There are also a considerable number of regulation and policy documents in this field – the Electricity Act 1992, the Commerce Act 1986, the Government Policy Statement, the New Zealand Energy Strategy, and the New Zealand Energy Efficiency and Conservation Strategy, to name a few.

In his first keynote speech as Energy Minister²⁰, Gerry Brownlee commented that there is a need to disentangle the regulatory overlap between Transpower, the Commerce Commission and the Electricity Commission. This is consistent with the National Party's Energy Policy, released in August 2008, as described in our article "[Improved rules for electricity lines businesses now in place](#)" in the Spring 2008 issue of Commercial Quarterly.

While Mr Brownlee acknowledged that resolving the regulatory confusion would take some time, the Government's first objective would be to reduce the number of grid upgrades that had to be approved by the Electricity Commission. This step has been taken with the publication of the proposed new Government Policy Statement on Electricity Governance, released on 2 March 2009.

Changes to the Government Policy Statement

The proposed changes to the Government Policy Statement address three main areas:

- Facilitating small grid upgrade investments by streamlining the investment approval process. For proposed grid upgrades where the total cost of a project is less than \$20 million, the Government proposes the following process:
 - Transpower will develop and submit grid upgrade plans to the Commission for approval. The grid upgrade plan should demonstrate the rationale for all expenditure, taking into account good industry practice for power system operation.
 - Once the Commission has received a grid upgrade plan, the Commission should approve the plan without undue delay provided that it is satisfied that Transpower has complied with the requirements in preparing the plan. The Commission should not be required to assess and evaluate the merits of small investment plans of a value less than \$20 million.
 - If Transpower wants to amend an approved grid upgrade plan it should follow the same process unless the total project cost under the amended plan exceeds \$20 million, in which case Transpower must follow the process for large grid upgrades.
- Removing all references to the New Zealand Energy Strategy (NZES) and the New Zealand Energy Efficiency and Conservation Strategy (NZECS). This is in anticipation of the NZES and the NZECS being reviewed later in the year. The NZES, released in October 2007, sets out an action plan to deliver clean, secure, affordable energy while treating the environment responsibly, and to respond to the risks of climate change by reducing the greenhouse gases caused by the production

²⁰ At the National Power Conference, Auckland, 24 February 2009.

and use of energy. The NZEECS (also released in October 2007) is an action plan to promote sustainability as part of New Zealand's national identity and drive economic transformation in business. The NZEECS targets energy efficiency in homes, business and transport, and promotes an efficient and renewable electricity system. The deletion of references to the NZES and the NZEECS in the Government Policy Statement is consistent with the shift in focus in relation to the electricity sector caused by the change in government. The focus of the Labour government was on energy efficiency and sustainability. While the National Party supports a target of achieving 90 percent renewable energy, it does not consider that this should be at the risk of security of supply.

- Consistent with the above changes, the Government Policy Statement now emphasises the priority the Government accords to security of supply policy by bringing this section forward.

Submissions

Submissions on the proposed changes to the Government Policy Statement close on 16 March 2009. See the Ministry of Economic Development's website for more information (http://www.med.govt.nz/templates/ContentTopicSummary_21482.aspx)

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

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Utilities and resources

Labour's ETS still in place but undergoing comprehensive review

In this article, senior associate Kate Radka provides an update on the Emissions Trading Scheme and the current review of the scheme by a special select committee established at the end of 2008.

Emissions Trading Scheme review

In September 2008, the then Labour-led government passed the Climate Change Response (Emissions Trading) Amendment Act 2008 (the Act), which established an emissions trading scheme in New Zealand (the ETS) retrospective (for forest land owners in particular) to January 2008. (See the article ["Emissions Trading Scheme - is it here to stay?"](#) in the Spring 2008 issue of Commercial Quarterly for a summary of the key features of the ETS, which are currently in place.)

ETS legislation not repealed

With National requiring the support of ACT to form a government, promises were made to suspend the operation of the ETS while a review of the scheme and alternative mechanisms for addressing climate change were to be considered. Although National has honoured the National-ACT agreement for confidence and supply by establishing a unique Select Committee of Inquiry (the Emissions Trading Scheme Review Committee) to review the ETS, it has not passed legislation to repeal the Act. Accordingly, the emissions trading scheme continues to apply in its current form while the Emissions Trading Scheme Review Committee conducts its review.

Membership of the review committee

The Emissions Trading Scheme Review Committee is comprised of members from many of the political parties sitting in Parliament with a view to obtaining a more balanced consensus on the framework of the scheme and consideration of other alternatives. It held its first meeting on 18 December 2008 and has called for submissions with a closing date of 27 February 2009.

Terms of reference

The select committee has not provided any specific guidance on the matters it will be considering beyond its invitation for submissions on any of the select committee's terms of reference or any related matters, where its terms of reference are to:

- hear views from trade and diplomatic experts on the international relations aspects of this issue;
- consider the prospects for an international agreement on climate change post Kyoto 1, and the form such an agreement might take;
- require a high quality, quantified regulatory impact analysis to be produced to identify the net benefits or costs to New Zealand of any policy action, including international relations and commercial benefits and costs;
- identify the central/benchmark projections which are being used as the motivation for international agreements to combat climate change; and consider the uncertainties and risks surrounding these projections;
- consider the impact on the New Zealand economy and New Zealand households of any climate change policies, having regard to the weak state of the economy, the need to safeguard New Zealand's international competitiveness, the position of trade-exposed industries, and the actions of competing countries;
- examine the relative merits of a mitigation or adaptation approach to climate change for New Zealand;
- consider the case for increasing resources devoted to New Zealand-specific climate change research;

- examine the relative merits of an emissions trading scheme or a tax on carbon or energy as a New Zealand response to climate change;
- consider the need for any additional regulatory interventions to combat climate change if a price mechanism (an ETS or a tax) is introduced; and
- consider the timing of introduction of any New Zealand measures, with particular reference to the outcome of the December 2009 Copenhagen meeting, the position of the United States, and the timetable for decisions and their implementation of the Australian government.

Timeline

It is expected that the select committee will report back in March or April 2009 and it is the Government's intention that the revised legislation will be passed by 30 September 2009 before the entry of the first business sectors into the scheme (other than forestry) commence in 2010. That said, forest land owners facing allocation and exemption deadlines from June 2009 are likely to put pressure on the Government to provide a level of certainty or comfort around any possible amendments to the legislation prior to that date. Similarly, the stationary energy sector participants with the ability to apply to opt-in as Schedule Four participants from 1 January 2010 have also been seeking some level of certainty as to the eventual framework of the scheme (and indeed whether an emissions trading scheme will even be retained) before taking the plunge and opting in.

Commentary

Comments from select committee members in the media, albeit on the premise that they are not wishing to pre-empt the findings of the committee, suggest that the ETS is likely to remain in place with few substantive amendments to its framework. Indeed, National may even struggle with ACT's stance on the ETS to find the necessary numbers to pass amendments to the Act.

Despite recent comments from select committee members, it is possible in the current economic climate and in light of the volatile carbon market that the government may seek to provide greater financial certainty for business, notably around the price of carbon, by providing for a price cap. A price cap, even as a temporary measure in the initial years of an emissions trading scheme, provides certainty as to the highest price of carbon and in effect imposes a carbon tax on participants once a threshold market price has been exceeded.

Irrespective of the position various business players are advocating in their submissions to the select committee, one common theme is the need for a level of certainty around the mechanism that will be used so that businesses can commence the necessary commercial and strategic planning to meet their compliance obligations, and manage their risk.

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Utilities and resources

Draft Forestry Allocation Plan and the need for pre-1990 foresters to act by mid-2009

The forestry aspects of New Zealand's emissions trading scheme became effective on 1 January 2008 and remain in force. In this article, senior associate Kate Radka provides an outline of the Draft Forestry Allocation Plan (which is currently under consultation) for the allocation of pre-1990 forests and the potential exemptions for such forests under the emissions trading scheme.

Background

As discussed in the article "Labour's ETS still in place but undergoing comprehensive review" in this issue of Commercial Quarterly, the emissions trading scheme (ETS) established under Climate Change Response (Emissions Trading) Amendment Act 2008 (the Act) is still in place despite the perceived "suspension" of the scheme during its review by the Emissions Trading Scheme Review Committee. For foresters the emissions trading scheme's retrospective nature means that they are liable for any deforestation of pre-1990 forest land and (if they opt into the scheme) for any net carbon stock decreases for post-1989 forest land since 1 January 2008.

Draft Forestry Allocation Plan

The "Draft Forestry Allocation Plan" issued by the Minister Responsible for Climate Change Issues, which elaborates on the proposed manner in which allocation will occur for pre-1990 forests, and the potential exemptions for such forests is currently being consulted on. Submissions on the draft Plan were originally due by 28 February 2009 but this date has now been extended to 30 April 2009 to avoid confusion with submissions on the Emissions Trading Scheme Review Committee's review of the ETS.

The Minister of Forestry David Carter has also indicated that the government intends to extend the closing date for when landowners with less than 50 hectares can apply for exemption from the ETS deforestation provisions (subject to the government's consideration of the Emissions Trading Scheme Review Committee's findings which are due to be released in April 2009).

Pre-1990 foresters should be aware of the need to:

- apply by 31 July 2009 (or such other date announced by the government) for a free allocation of New Zealand Units (NZUs) to recognise the loss in value of their land due to the mandatory deforestation liabilities under the emissions trading scheme; or
- if eligible, apply by 30 June 2009 (or such other date announced by the government) to have land permanently exempt from the emissions trading scheme (under the "less than 50 hectare" threshold exemption).

Failure to apply for either an allocation of free NZUs or an exemption from liability would cost foresters significantly. For example:

- an exemption from the ETS of approximately 40 ha of pre-1990 forest land that the owner wishes to deforest, will save the landowner up to \$800,000 in ETS deforestation liabilities (assuming a price of carbon of \$25 per tonne), save the amount of the value of any free allocation of units that they would otherwise receive; and
- a successful applicant for the allocation of NZUs for their pre-1990 forests would receive:
 - 39 NZUs per ha for land bought after October 2002 (so for 500 ha of such land they would receive 19,500 NZUs, worth around \$487,500, assuming an average price of \$25 per unit);
 - Considerably more than 39 NZUs per ha (perhaps around 60 NZUs per ha) for land bought prior to 1 November 2002 (so for 500 ha of such land they would receive potentially 30,000 NZUs, worth around \$750,000, again assuming an average price of \$25 per unit).

Commentary

In most cases, foresters must choose between an exemption for their land from the ETS or a free allocation of units. In any respect a free allocation and an exemption cannot be applied for in terms of the same area of land. However, in some instances, a forester may be able to apply for an exemption for some of their land holding and a free allocation for other parts.

Given the significant financial benefits available in respect of the free allocation of NZUs for such forests, as well as the potential exemptions available, foresters need to carefully consider their options and ensure that they submit their applications in the form required by the specified deadlines.

To access a copy of the Draft Forestry Allocation Plan visit the Ministry of Agriculture and Forestry at www.maf.govt.nz

If you would like to discuss any aspect of the Draft Forestry Allocation Plan, please contact any of the Bell Gully team listed below. We will keep you updated on further developments.

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Bell Gully News

[Economic calamity makes time right for Maori and Crown to forge lasting collaboration](#)

While the National-led Government is tackling economic challenges of unparalleled magnitude, there is no better time for it to forge new territory in our country's history: a sustainable way forward for Maori and the Crown.

[Waste Minimisation Act 2008](#)

Once of the pieces of legislation that was squeezed into its final reading in the last session of Parliament before the election was the Waste Minimisation Act 2008.

[Bell Gully advises on Fletcher Building's capital raising](#)

Bell Gully has advised Fletcher Building Finance on its capital notes offer, which raised \$131.3 million, and on the company's sale of its Auckland headquarters.

[Leading competition law practice belongs to Bell Gully](#)

As the Commerce Commission takes an increasingly public profile in New Zealand and competition law issues continue to expand, leading international publisher *Global Competition Review* has judged Bell Gully's competition law team as New Zealand's best.

[Bell Gully authors New Zealand chapter in global gas publication](#)

Bell Gully partner and energy specialist David Coull has authored the New Zealand chapter of a publication focusing on the international gas sector.

[Summer clerks escape the office for a good cause](#)

As part of this year's summer clerk programme, Bell Gully's newest lawyers visited the homes of those affected by leukaemia and other blood related conditions to lend a helping hand.

[\\$100,000 penalty for spamming](#)

The High Court has recently considered the Unsolicited Electronic Messages Act 2007 for the first time, and ordered a spammer to pay \$100,000.

[RMA reforms signal a step in the right direction](#)

Bell Gully welcomes the Government's announcement that it will be embarking on a significant series of reforms to the Resource Management Act.

[Bell Gully partners again recognised by Asialaw](#)

Bell Gully partners continue to feature as "leading lawyers" in the 2008 edition of Asialaw Leading Lawyers.

[New Zealand insolvency expertise shared in specialist global guide](#)

The New Zealand legal landscape around insolvency has been outlined by recognised Bell Gully specialist Murray Tingey in a newly released global publication.

[Attack on rural activities: a mushrooming problem?](#)

Meadow Mushrooms' decision to shut its Waikato growing operation, with more than 160 jobs lost, could not have come at a worse time for staff and the Morrinsville community – but it may also signal what's to come for more in the rural sector.

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]