



BELL GULLY

Financial Services Quarterly

AUTUMN 2009



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financial services quarterly

Welcome to the Autumn 2009 issue of *Financial Services Quarterly*, a review of current legal issues in the financial sector.

Each quarter, we summarise recent issues and preview upcoming developments under these headings:

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Government takes first step to implement its overseas investment review

The Minister of Finance and the Minister for Land Information have issued to the Overseas Investment Office a new Designation and Delegation letter that provides the first opportunity to consider how the government may implement the outcome of its review of the overseas investment regime. We outline the key aspects of the government's review and consider whether the Designation and Delegation letter is a step in the right direction.

Update on the Securities Disclosure and Financial Advisers Amendment Bill

The Commerce Select Committee has reported back on the Securities Disclosure and Financial Advisers Amendment Bill, introduced into Parliament in February, with only minor amendments. We look at the select committee's recommendations and discuss some of the shortcomings with their proposed amendments.

Insurance (Prudential Supervision) Bill

The bill proposes the introduction of limitations on statutory funds.

In the journals

Enforcement of security interests: a general guide to interpreting New Zealand's system of overlaying statutes

This article considers the jurisdictional mix created by the four statutes governing the enforcement of security interests in New Zealand.

Mercury Tax Group v HMRC and the importance of 'execution formalities'

A recent English case serves as a useful reminder of the importance of the so-called 'execution formalities' applicable to the signing of legal documents.

Re Octaviar Ltd: unsettling implications for secured financings

This article discusses an Australian case about registration of variations to registered charges.

Recent Developments

An update on corporate governance in the wake of the credit crisis

A number of recent reports have identified deficiencies in the corporate governance practices of many failed companies. We take a closer look at some of these reports and highlight some key findings for New Zealand companies' corporate governance practices.

New Zealand's Emissions Trading Scheme – still up in the air?

We discuss the likely outcome for New Zealand's Emissions Trading Scheme in the light of its current review and recent economic events.

In the courts

Retention of title arrangement not necessarily a security interest under the PPSA

The Court of Appeal has overturned the High Court's decision that a retention of title arrangement created a registerable security interest.

This case¹ concerned parties who entered into a supply agreement that included a security interest in the form of a retention of title clause. The supplier tried to protect its position by requiring payment before delivery. The supply agreement provided that delivery of goods was only to be made on receipt of cleared funds and that unconditional ownership would pass to the purchaser following payment. Brokers were therefore only authorised to release the goods to the purchaser on receipt from the supplier of a buyer delivery order.

An employee of the purchaser mistakenly wrote to the brokers requesting that they release goods to the purchaser prior to payment. The brokers then released the goods to the purchaser without the supplier's authority.

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

The purchaser opposed the application, arguing that the supplier had an unperfected security interest in the goods, which ranked behind the perfected security interest of the purchaser's lender.

High Court

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

Court of Appeal

The Court of Appeal considered:

- whether the receiver's retention of the goods amounted to conversion; and
- whether the retention of title arrangement was an unperfected security interest under the PPSA, giving the lender priority in the goods under the purchaser's possession.

Whether the receiver's retention of the goods amounted to conversion:

- The supplier had not voluntarily released the goods because the brokers were not acting within the scope of their express authority when they released the goods.
- It could not be suggested that the brokers had implied authority to release the goods because that would have been inconsistent with their express authority.
- There could be no ostensible authority because there had been no representation by the supplier that the brokers had authority to release the goods, and the purchaser knew that the brokers' authority was limited (the mistake being as to whether payment had been made, but not as to the scope of the authority).

¹ J S Brooksbank and Company (Australasia) Ltd v EXFTX Ltd (in receivership and liquidation) [6 April 2009] CA698/07

- The High Court was wrong to find that delivery of the goods created a debt that the purchaser was obliged to meet. Because the purchaser was not obliged to accept delivery, it could have returned the goods and accordingly, the supplier was entitled to seek the return of the goods.

Whether a security interest had attached to the goods

The Court of Appeal went on to find that the position was not affected by the PPSA because the supplier did not have a security interest under the PPSA, and the lender's registered security interest had not attached to the goods.

The court found that the supply agreement was not a conditional sale agreement and consequently not a 'deemed security interest' under section 17 of the PPSA. This was because retention of title clauses intended to be caught under section 17 contemplate the possibility of delivery of goods prior to payment, and their purpose is to enable the supplier to have recourse to the goods if payment is not made. In this case, there was to be no delivery until payment had been made and the supply agreement was specifically formulated to prevent the supplier from having any credit exposure to the purchaser.

The specific point that the Court of Appeal found against the formation of a security interest was that the supply agreement "in substance" did not secure payment or performance of an obligation. The fact that delivery was mistakenly effected prior to payment (but title did not transfer) did not change the arrangement from one that in substance did not create a security interest into one that did.

The original High Court decision in this case created some controversy, as it seemed to cast the net quite wide in terms of when a security interest might arise. The Court of Appeal's decision does not serve to limit the scope of what might constitute an "in substance" security interest, it instead reminds us that to have an "in substance" security interest the transaction involved must secure payment or performance of an obligation. Some practical matters to keep in mind are:

- When drafting or interpreting a supply contract, take care when considering whether the transactions set out in the contract will give rise to a security interest. Seek professional advice if you have a concern, as it is better to identify an issue at the outset than find out when you come to enforce your contract that you have an unperfected security interest.
- Ensure that you perfect any security interest by registering a financing statement on the PPSR within the applicable timeframe. Failure to do so could result in your security interest being defeated by perfected security interests in respect of the same goods.
- When drafting a supply contract that creates a security interest, ensure that the contract contains an adequate description of the goods being supplied by item or kind such that it will enable the goods to be identified. Failure to do so may affect the enforceability of your security interest.
- Ensure that the information provided in the financing statement (including the description of the collateral) is accurate. If a registration is "seriously misleading" because of an error or omission in a financing statement, the supplier's security interest may be rendered unenforceable.

Assignment by way of security may not be enforceable under Part 9 of the PPSA

In a successful application to have a statutory demand set aside, the court decided that, while it was unclear whether a "transfer" included an assignment by way of security, or was limited to absolute transfers, it was reasonably arguable that section 105(b)(i) of the Personal Property Securities Act (PPSA) prevented the lender from enforcing its security interest under Part 9 of the PPSA.

In this case¹, the defendant was a member of a group of companies referred to as the Thompson Group. The Thompson Group had dealings in land with another group of companies known as the Brown Group. The result of those dealings was that certain payments were due from the Thompson Group to the Brown Group.

The Thompson Group agreed to grant the Brown Group a mortgage over land. The parties entered into a settlement agreement, which provided that the Thompson group would pay \$500,000 to the Brown Group on a specified date, and that the mortgage would be discharged when that payment was made.

In time, a finance company lent money to a company in the Brown group. That loan was secured by an assignment to the finance company of the debt, by way of a mortgage, under the settlement agreement. The assignment was registered on the Personal Property Securities Register.

Subsequently, the borrower failed to repay the loan and the finance company made a statutory demand against the defendant for \$500,000, which it contended was due under the assignment of debt.

Issue

The defendant challenged the legal effect of the assignment, arguing that it was not an absolute assignment of debt but rather an assignment by way of security. As such, the defendant argued that the finance company was only entitled to receive any payments due to the assignors.

Arguments

The finance company argued that its rights stemmed from the interest under the PPSA and not by virtue of rights acquired by a mortgage of property at common law. It claimed it had a deemed security interest under section 17(1)(b) of the PPSA, being "... an interest created or provided for by a transfer of an account receivable or chattel paper ...". It contended that:

- section 108 of the PPSA gives a secured party the right to apply an account receivable taken as collateral to the satisfaction of the obligation secured by the security interest if the debtor is in default; and
- when there was a default under the loan agreement it became entitled to call up and collect the account receivable of \$500,000 by issuing the statutory demand.

The finance company further claimed that the PPSA did away with the need to be concerned with distinctions between absolute assignments and assignments by way of charge or mortgage, and that the PPSA was intended to simplify distinctions between legal mortgages, equitable mortgages, equitable charges, floating charges, pledges, liens, hypothecation and reservation of property or title.

In response, the defendant argued that the PPSA did not apply to the assignment of debt because the right of payment transferred to the finance company arose in connection with an interest in land. It noted that section 23(e)(ii) of the PPSA provides that the PPSA does not apply to an interest created or provided for by "a transfer of a right to payment that arises in connection with an interest in land ... unless the payment is evidenced by an investment security", and there was no investment security.

The court noted that section 105(b)(i) of the PPSA provides that Part 9 of the PPSA (which deals with the rights and obligations of a secured party when enforcing a security interest) does not apply to a security

¹ *Blue Water Resort Limited v MARAC Finance Limited* (2009) 9 NZBLC 102,409

interest that is created or provided for by a transfer of an account receivable or chattel paper. It referred to the view of some commentators that the term "transfer" in that provision should be limited to absolute transfers of accounts receivable and chattel paper because there was no reason to exclude, from Part 9, agreements documented as a transfer by way of mortgage.

Decision

In its application to have the statutory demand set aside, the defendant needed to show that there was a substantial dispute to be heard.

The associate judge determined that the threshold had been met because:

- it was likely that the assignment was not absolute (expressed to be by way of mortgage) and therefore could not be directly enforced by the lender at common law;
- although the assignment might be a deemed security interest under section 17(1)(b) of the PPSA (an interest created or provided for by a transfer of an account receivable), the application of the PPSA was arguably excluded under section 23(e)(ii) because the settlement debt arose in connection with an interest in land; and
- section 105(b)(i) of the PPSA provided that the enforcement provisions of Part 9 did not apply to a security interest created by a transfer of an account receivable.

While it was unclear whether a "transfer" included an assignment by way of security, or was limited to absolute transfers, it was reasonably arguable that this provision prevented the lender from enforcing its security interest under Part 9 of the PPSA.

The importance of getting solicitor's certificates right

Summary judgment was ordered in favour of a bank against a firm of solicitors for breach of a solicitor's certificate and undertaking. The solicitors had acted for both the bank and the borrower in connection with a loan and security.

In this case¹, the bank instructed the solicitors to register a first ranking mortgage over the borrower's property as security for an advance to the borrower. At the time there were three prior mortgages registered over the property.

The solicitors provided a certificate to the bank, which included the following statements:

2. We have made such enquiries and searches as are appropriate as at the date of this certificate (including obtaining a guaranteed search of the property...
 3. We confirm that except for the interests (if any) referred to in paragraph 4 below, we are not aware of anything which would prevent the bank's mortgage in relation to the property being registered and obtaining the priority required by the bank.
 4. We have obtained releases of, or satisfactory undertakings to provide releases on settlement in respect of all encumbrances registered against the property other than those described in Schedule 3 in respect of which the bank's consent has been obtained. [Schedule 3 was empty]
- 10.1 We will promptly lodge or submit, in registerable form to Land Information New Zealand ("LINZ"), all Documents [as defined in the instructions] which are required by the bank to be registered (or the non-registration of which might affect the priority of the bank's security).

Relying on this certificate, the bank advanced the loan to the borrower.

The solicitors discharged the first ranking mortgage but were unable to obtain the necessary releases from the second mortgagee. Solicitors for the second mortgagee had provided a conditional undertaking to provide the necessary releases but did not accept that its conditions were satisfied.

The bank's mortgage was eventually registered some months later, ranking third.

Subsequently, the second mortgagee sold the property at mortgagee sale and the proceeds were insufficient to repay the bank's advance.

Did the solicitors give the bank an undertaking to ensure its mortgage would be a first registered mortgage?

The bank argued that the undertaking couldn't be clearer from the terms of the solicitor's certificate, whereas the solicitors argued that the only undertaking was in 10.1, which it claimed it had complied with.

The bank's instructions had asked for a "registered first and only mortgage" which the solicitors claimed was a misnomer on the basis that it is not possible to lodge a "registered first and only mortgage" - one can only lodge a mortgage that, on registration, may become the first mortgage registered on the title.

The solicitors further argued that the statements in 2, 3 and 4 were merely representations, and not undertakings. Even if the representations did constitute undertakings, they were correct because they had obtained an undertaking to provide releases that were "satisfactory" to it, even though the undertaking was conditional. It believed that the second mortgagee would discharge its mortgages.

Did the solicitors do what was required to satisfy the undertaking?

The judge accepted the bank's argument, deciding that there was no ambiguity in the bank's instructions and the solicitor's certificate.

¹ *Westpac New Zealand Limited v Neumegen & Co* [16 December 2008] HC, Auckland, CIV-2007-404-006529

While the judge accepted that an undertaking is a promise to do a future act and the statements in 3 and 4 of the solicitor's certificate did not contain promises of future action, the judge said that the significance of those paragraphs was not whether they were undertakings, but that they formed part of the context in which the undertaking in clause 10.1 was given.

The undertaking was clear, and it was clear that it had been breached by the solicitors because they had not done what was required to satisfy the undertaking, as evidenced by the outcome.

The solicitors were ordered to pay compensation to the bank in the amount owing under the loan agreement, including accrued interest.

Agency/trust relationship or debtor/creditor relationship?

The Court of Appeal has agreed with the High Court that the critical issue in determining whether an arrangement is of an agency/trust or debtor/creditor nature is whether the supplier is required to keep the funds in a separate account.

In this case¹, a council collected rubbish and required users of the service to use branded plastic bags. An arrangement was entered into with a company to sell the bags to retailers at a set price. The set price included the fees charged by the council for collection of the rubbish. The council would then invoice the bag supplier for the collection fees, irrespective of what the supplier had received from selling the bags.

The supplier went into receivership and the receivers applied for a determination as to whether the council had a proprietary interest in the fees portion of the sale price of the rubbish bags.

The High Court held that the relationship of the council and the supplier was not one of principal and agent, with the result that the supplier was not holding the collection fees on the council's behalf. It observed that, even if the council did have a proprietary interest in the collection fees, that interest would have constituted a security interest for the purposes of the Personal Property Securities Act 1999 and would have ranked after the security of the appointer.

The Court of Appeal dismissed the council's appeal, stating that the critical issue in determining whether the arrangement was of an agency/trust or debtor/creditor nature was whether the supplier was required to keep the funds in a separate account. Whether it was right to start with a presumption against an agency/trust arrangement was open to question, but the usual incidents of a commercial arrangement whereby there were a series of running transactions indicated that there had been no requirement to keep the funds separate.

The difficulty in this situation was that the supplier was obliged to pay the council regardless of whether it had been paid by the retailers. If the supplier had been required to hold the payments from retailers in a separate account (as a trustee), that money would not have exhausted the obligations of the supplier to the council.

¹ *Stiassny v North Shore City Council* CA 713/07; [2008] NZCA 522

CCCFA buy-back provisions do not assist victims of a fraudulent buy-back transaction

A couple whose house was fraudulently transferred to a bona fide purchaser for value failed in their bid to recover their home under the CCCFA buy back provisions.

This case¹ was brought by a couple who entered into an investment scheme under which they understood title to their property was to be transferred to a “secure family trust” administered by the managers of the scheme. The promoters of the scheme told them that title to their property would be returned to them at the end of the investment term.

However, the trustees who now had title to their property claimed they had purchased the property outright from a company associated with management of the investment scheme. In order to buy the property, the trustees had borrowed a loan from a bank, and had given a registered mortgage over the property.

The couple tried to have the bank’s mortgage set aside, claiming that the investment scheme was an oppressive buy-back transaction that should be reopened by the court under the Credit Contracts and Consumer Finance Act 2003 (the Act). They said that the bank’s mortgage was taken in connection with the investment scheme and therefore should be treated as forming part of the buy-back transaction.

Alternatively, the couple argued that the trust’s solicitor had been fraudulent and that because the solicitor had also acted for the bank, the solicitor’s knowledge should be imputed to the bank. The same solicitor had acted for the bank in arranging for the loan and mortgage documents to be signed by the trustees, and in registering the mortgage and transfer at the Land Titles Office. Therefore, they said that the mortgage should be set aside on the basis of the fraud exception to the principle of indefeasibility under the Land Transfer Act (the LTA).

Granting the bank’s application to strike out the couple’s claim, the court held that the mortgage was not a “security interest” for the purposes of the Act and was not taken in connection with the buy-back transaction. It also rejected the argument that the knowledge the solicitor gained while acting for the trustees should be imputed to the bank so as to bring the case within the fraud exception to indefeasibility.

The couple applied for a review of the associate judge’s decision, and the following issues were considered.

Was the mortgage a “security interest” taken in connection with the investment scheme and therefore part of the buy-back transaction?

The judge did not accept that there was any basis to the argument that the loan agreement or the mortgage secured the performance of obligations in the buy-back transaction. The policy underlying the CCCFA does not warrant a broad interpretation giving preference to the homeowner over the innocent financier, and such interpretation would cut across the principles of indefeasibility and create considerable uncertainty for lenders.

Impact of the CCCFA on the indefeasibility provisions of the LTA

While the judge thought that the powers of the court under the CCCFA might extend, in appropriate cases, to making orders divesting a registered interest, he did not accept that such power was intended to override the interests of a bona fide purchaser for value.

Could the knowledge of the solicitor be imputed to the bank so as to bring the case within the fraud exception to indefeasibility?

The solicitor’s instructions from the bank were limited to the particular function of attending to have the documents executed and the mortgage registered. The judge held that, given the limited mandate, any knowledge that the solicitor gained when acting for the trustees should not be imputed to the bank. To hold otherwise would necessitate a significant change to current conveyancing practice.

¹ *Burmeister & Anor v O’Brien & Ors*, High Court, Tauranga, CIV-2005-470-000396

Guarantor's claim to right of subrogation fails against second mortgagee

The Court of Appeal has decided that a guarantor had no rights of subrogation vis-a-vis a second mortgagee because it had provided a guarantee and granted a mortgage to the second mortgagee.

In this case¹, a developer borrowed money to construct 18 houses, giving first, second and third mortgages over the properties to three separate lenders as security. Each loan was also secured by a couple who granted first, second and third mortgages over their home and an investment unit.

When the developer failed to pay amounts owing under the loans, the guarantors sold their properties and paid the net proceeds to the first mortgagee.

The three mortgages over those properties were discharged on settlement, even though neither of the second or third mortgagees received any of the proceeds of sale.

Exercising its power of sale over the developer's properties, the first mortgagee applied the net proceeds in further reduction of its mortgage debt, and paid the surplus to the second mortgagee.

The guarantors claimed entitlement to the benefit of the security held by the first mortgagee under the law of subrogation (which is a common law right of one party to step into the shoes of another so as to have the benefit of the other party's rights and remedies against a third party). They claimed this right arose when they paid the first mortgagee the proceeds from the sale of their properties.

The guarantors sued:

- the first mortgagee for breach of trust; and
- the second mortgagee to recover the surplus paid to it by the first mortgagee (which was alleged to be the guarantors' trust property).

The High Court decided that the guarantors' rights of subrogation protected them from unconscionable conduct by the first mortgagee, but that the first mortgagee had not acted unconscionably in transferring the surplus to the second mortgagee.

The guarantors' appeal to the Court of Appeal was dismissed on the basis that the principles of subrogation had no application in this case. The second mortgagee advanced its loan with knowledge of the first mortgagee, and presumably with knowledge of the guarantee. However, in addition to its mortgage over the developer's property, it took a guarantee from the guarantors and a mortgage over the guarantors' properties as security for the guarantee. Accordingly, the plain intention was that the second mortgagee was to have recourse to the developer's properties after the first mortgagee, and prior to any entitlement the guarantors might have.

The obligations undertaken by the guarantors to the second mortgagee were inconsistent with them having a prior claim to the borrower's properties.

¹ *Bofinger v Kingsway Group Pty Ltd* [2008] NSWCA 332

Legislation/In Parliament

Consumer credit contracts – more onerous disclosure requirements for break fees?

A member's bill is being put forward by National MP Aaron Gilmore with the aim of requiring lenders to tell borrowers the amount of costs payable if they break their mortgages.

Gilmore's press release states that the Credit Contracts and Consumer Finance (Break Fee Disclosure) Amendment Bill will require banks and other credit providers to include the dollar amount of any break fee payable in the credit contract, as well as a plain English description of the calculation.

This will be of concern to many creditors, particularly the suggestion that a dollar amount could be included in the initial disclosure information. The factors that determine the amount of a break fee at any time are numerous, including interest rate movements at that time, how the relevant credit contract is funded by the creditor, any re-lending policies of the particular creditor, the remaining term of the loan at that time and so on. It would be very unusual for a creditor to be able to forecast a break fee at the outset of a credit contract.

The press release goes on to say that "currently lenders do not have to disclose the fee that may or may not be charged at the time of entering the contract. The formula used to calculate the fee may only be included as part of the terms and conditions of the contract. It differs from lender to lender and can be too complicated for many people to understand. Significantly, as part of the terms and conditions, it can be changed by the lender without notice".

Creditors will also be concerned about these claims. Under the Credit Contracts and Consumer Finance Act 2003 (the CCCFA), creditors are already required to:

- make initial disclosure of all credit fees (including break fees) that are, or may become, payable under a consumer credit contract, including the amount of each fee (if ascertainable) or (if not) the method of calculation of the fee or charge (and, although not compulsory, a model initial disclosure statement is provided under the CCCFA's regulations for this purpose);
- make all disclosures in accordance with the standards set out in the CCCFA, including the requirement to express information clearly, concisely, and in a manner likely to bring the information to the attention of a reasonable person;
- allow a borrower to cancel a consumer credit contract within three working days of initial disclosure (or at any time if initial disclosure is not made);
- give notice of any changes to terms and conditions in accordance with the provisions of both the terms and conditions themselves and the CCCFA (which, at a minimum, means that creditors must advise fee changes by public notice); and
- ensure that all credit fees (including break fees) are not unreasonable.

It is difficult to argue with the contention that break fee calculations differ from lender to lender and are not necessarily understood by average consumers. However, while encouraging clear and comprehensible disclosure of fees to consumers is to be applauded, creditors are likely to feel that amendments to the CCCFA are superfluous for this purpose given the existing requirements of that legislation.

Additionally, [a recent High Court decision](#) has highlighted that lenders are not, and should not be, constrained from adopting different fee calculations to reflect their different business structures. A "one-size-fits-all" approach to calculating break fees is not commercially appropriate.

The real issue here, then, may be the need to improve standards of financial literacy and awareness among the general public. In particular, the need to read, compare and ask questions about initial disclosure information and contractual terms.

The progress (if any) of Gilmore's member's bill through Parliament will be followed with interest, but creditors will be likely to remain concerned about the possibility of increased regulatory scrutiny of their break fee calculations and business models for consumer lending.

Proposed securities regulation changes released

Changes to make it easier for businesses to raise capital are a step closer with the government's release in April 2009 of a discussion document on proposed changes to securities regulations. The discussion document, which highlights proposals to improve flexibility for issuers, is a response to the recommendations of the government-appointed Capital Market Development Taskforce. In this article, partner Andrew Brown and senior associate Stephen Layburn outline the proposed changes.

The discussion document addresses both the Capital Market Development (CMD) Taskforce's headline recommendations aimed at making securities disclosure more meaningful, as well as the CMD Taskforce's recommendation for urgent implementation of the Securities Commission's modernisation study and resulting recommendations dating back to 1999-2000.

KEY CHANGES

The major amendments proposed in the discussion document are outlined below.

Financial statements

The discussion document proposes that the Securities Regulations be changed to require financial statements used in prospectuses for offers of equity, debt or participatory securities to be prepared in accordance with New Zealand International Financial Reporting Standards (NZIFRS), which is the requirement under the Financial Reporting Act 1993. Currently, the content requirement prescribed by the Securities Regulations for the financial statements that are to be contained in a prospectus differ from those under the Financial Reporting Act. This can lead to issuers having to prepare two different sets of financial statements. The change is expected to be welcomed, and should reduce compliance costs.

Definition of borrowing group

In the context of an offer of debt securities, the Securities Regulations currently require disclosures in relation to the borrowing group - being the issuer of the debt securities and any guaranteeing subsidiaries. However, many issues of debt securities include guarantees by parent and sister entities, which do not presently fall within the meaning of the "borrowing group". Consequently, a change is proposed to the Securities Regulations to include disclosure about guaranteeing parent and sister entities to ensure proper disclosure about all entities that are guaranteeing the issuer's obligations.

Prospective financial information

The Securities Regulations currently require prospectuses for initial offerings of equity securities to contain a prospective statement of cash flows for the next 12 months, rather than full prospective financial statements. This requirement has been heavily criticised on a variety of levels, including that it does not provide meaningful information. A recommendation has been made to require full prospective financial statements.

Disclosure of interests

A proposed change to ensure that the disclosure of directors', promoters' and managers' interests is consistent across all types of securities offerings (including equity, debt, unit trusts, life insurance policies and superannuation schemes) has been recommended. At present, differing disclosure obligations for different kinds of issuers contributes to a lack of uniformity, and allegations that it hampers meaningful comparison between different investment products.

Consideration for securities

A change is recommended to provide for the Securities Regulations to enable the price/consideration payable for securities to be determined by a formula, so long as the formula is set out in full and clearly explained. The absence of such flexibility is an example of the need to bring the content requirements

up to date because the disclosure of price/consideration payable routinely leads to requests for exemptions by the Securities Commission.

Flexibility in advertisements

The Securities Regulations also prescribe the content requirements for promotional material covering securities offers. Among the proposals are measures designed to provide more flexibility about the financial information that may be contained in advertisements. First, it is proposed to relax the current restriction that only allows securities advertisements to contain prospective information that is included in the relevant prospectus for the securities, including by allowing references to commentary or analysis of prospective financial information. Secondly, a proposal to allow advertisements to include information from interim or unaudited financial statements regarding the net assets and assets and liabilities of the issuer. This development is to address the difficulties encountered where the audited (annual) financial statements are not the most recently published financial information available.

Modernisation

Measures to address a number of known problems with the Securities Regulations, including by closing a loop-hole over distribution of advertisements via the internet. Other changes are proposed by way of a limited re-write of the Securities Regulations to rid them of outdated terminology, unclear definitions and otherwise undertake a modernisation exercise. The re-write is not intended to change the substantive effect of the Securities Regulations.

SIMPLIFIED DISCLOSURE - PROSPECTUS REGULATIONS

The draft regulations required to implement the simplified disclosure prospectus (SDP) (which features in amendments to the Securities Act 1978 contained in the Securities Disclosure and Financial Advisers Amendment Bill now before Parliament) were not included as part of this discussion document. However, the discussion document did seek views on whether the use of a SDP should be restricted to "non-complex" products such as shares, preference shares, securities that convert into ordinary shares of the same issuer and debt securities.

A draft of the SDP regulations was released by MED in May 2009 for consultation.

MUCH-WELCOMED CHANGE

A number of the proposals contained in the discussion document represent a much-welcomed update to detailed content requirements which are out-of-date and/or unwieldy.

The closing date for submissions was 8 May 2009, but there is no indication yet as to when MED is likely to implement the proposals. The discussion document and the consequential changes to the Securities Regulations are very much a stop-gap measure pending a more thorough review of the Securities Act which, we understand, is scheduled for later this year.

To access a copy of the discussion document visit the Ministry of Economic Development's website at www.med.govt.nz or [click here](#).

For a copy of Bell Gully's submissions on the discussion document [click here](#).

Government takes first step to implement its overseas investment review

On 22 April 2009, the Minister of Finance and the Minister for Land Information issued to the Overseas Investment Office a new Designation and Delegation letter. The letter provides the first opportunity to consider how the government may implement the outcome of its review of the overseas investment regime. The letter, setting out the powers and functions delegated to the Overseas Investment Office, is intended to result in fewer applications needing a ministerial decision, with the hope of increasing the timeliness of the application process.

Partner David Boswell outlines the key aspects of the government's review and considers whether the Designation and Delegation letter is a step in the right direction.

Background

The current Overseas Investment Act and Regulations resulted from the Labour Government's 2003/2004 review of the 1973 overseas investment regime. One of the underlying objectives of this review was to establish relatively liberal overseas investment rules in order to develop the New Zealand economy to its full potential, while, at the same time, providing greater protection for New Zealand iconic sites of special, historical, cultural or environmental interest. This was to be achieved through a narrower focus on assets of critical interest, including those unique assets requiring protection.

The current regime has been widely criticised by those wanting to attract foreign investment into New Zealand. Most of the criticism is directed at the structure, process (particularly the uncertain, and at times lengthy, timeframe for a decision) and the complexity of the regime, and not at the fundamental concepts enshrined in the legislation.

While there has been little disagreement over the need to have an overseas investment regime that both attracts overseas investment, and, at the same time, protects New Zealand's strategic and unique assets, it has become obvious that the current legislation is too cumbersome and complex and is in need of reform.

2009 review of the overseas investment regime

In announcing the terms of reference for the 2009 review, the government acknowledged there is scope to improve the design and implementation of the current overseas investment screening regime to ensure that it provides clarity, certainty and predictability for overseas investors. It also noted that it would like to ensure that investment applications are processed efficiently and in a way that minimises compliance costs for overseas investors.

The review is being led by the Minister of Land Information with the assistance of Treasury and the Overseas Investment Office. A Technical Reference Group has also been established to advise officials on the practicality of any proposed amendments and to provide suggestions on other improvements that can be made to the regime.

The 2009 review is unlikely to result in a complete new set of laws for overseas investment. The government has indicated that its focus will be on the "most problematic areas of the legislation so that unnecessary barriers to foreign investment can be quickly identified and removed".

Changes arising from the review may be implemented in three ways.

- First, by way of ministerial directive letters to the Overseas Investment Office to extend its delegated authority, and to provide to the Overseas Investment Office direction on government policy.
- Secondly, by cabinet amending the Regulations.
- Other changes involving wider issues currently dealt with by the Overseas Investment Act 2005 may be made by Parliament amending the Act.

The government has not set a timetable to complete the review and enact any necessary changes. It is expected to take several months to complete. It is anticipated that cabinet will consider recommendations arising from the review during the next few months, with any new regulations implemented well before the end of this year. If changes to the 2005 Act are recommended, they will take longer to enact. There is likely to be some public consultation during the select committee process, which may mean the Act is not amended until the end of 2009 at the earliest.

However, the government is not so constrained by process when it comes to issuing ministerial directives. It has not waited to complete the review before issuing the April Designation and Delegation letter.

New Designation and Delegation letter

In December 2007, the Labour Government, through its Designation and Delegation letter to the Overseas Investment Office, substantially increased the delegated decision-making role of the Overseas Investment Office so that ministerial approval was only required for a limited number of categories of "sensitive land".

The government's April 2009 Designation and Delegation letter further reduces the number of applications requiring ministerial approval by increasing the categories of special land applications that can be considered by the Overseas Investment Office. This is consistent with the government's stated intention to reduce application times. However, it remains to be seen whether the government has gone far enough to make a material difference, as there are still a number of categories of "sensitive land" decisions requiring ministerial approval.

It is understandable why ministers want to retain the ultimate decision-making power when non-urban land exceeding five hectares adjoins certain unique assets such as the foreshore and seabed, regional parks and land administered by the Department of Conservation. However, it is more difficult to understand why ministers still require this right in other situations, such as when the sensitive land being acquired adjoins such things as a reserve or a public park.

The issuing of the Ministerial Directive letter to the Overseas Investment Office gave the government the opportunity to move quickly to help address common criticisms of the present regime, namely that it takes too long to obtain an OIO consent and that too many low level applications require ministerial approval. While the latest Ministerial Directive improves the position, especially for transactions involving urban land, unfortunately, by being reluctant to change the level of delegation to make decisions on non-urban sensitive land, the government has not made the most of this opportunity.

2009 OECD Report

The OECD recently released its Economic Survey on New Zealand. In its report, the OECD noted that New Zealand has one of the highest amounts of inward foreign direct investment (FDI) relative to GDP among OECD countries. The report then went on to note that, despite this good performance, "OECD comparisons suggest that New Zealand could do even more to create a welcoming environment for FDI. The latest OECD FDI restrictiveness index showed that, in 2006, FDI restrictions in New Zealand were still above OECD averages in 6 out of the 9 sectors examined."

The report then went on to suggest that New Zealand should do something to ease current screening requirements, noting the information showed that "screening requirements in New Zealand are some of the highest among OECD countries".

Way forward

Those wanting to see reform by the removal of unnecessary red tape, delay and cost no doubt hope that the government takes notice of the comments from the OECD report and listens to the feedback from the Technical Reference Group it has appointed. They will also be looking for evidence that the government remains committed to its objectives of providing clarity, certainty and predictability and to establishing an environment that allows applications to be processed efficiently and in a way that minimises compliance costs.

The April Designation and Delegation letter provides some comfort that the government will implement the necessary changes. However, because of the somewhat tentative approach it adopted when delegating to the Overseas Investment Office decisions on certain non-urban sensitive land, there is, as

yet, no clear indication that the government will go far enough to make the necessary reforms to rectify all of the major shortcomings with the current regime.

Time will tell whether the government makes the most of the current opportunity to achieve reform so that the overseas investment regime encourages desirable overseas investment while, at the same time, ensuring protection of New Zealand strategic and unique assets.

We will keep you updated on any further developments.

Update on the Securities Disclosure and Financial Advisers Amendment Bill

On 30 April 2009, the Commerce Select Committee reported back on the Securities Disclosure and Financial Advisers Amendment Bill, introduced into Parliament on 18 February 2009, with only minor amendments. This article outlines the select committee's recommendations and discusses some of the shortcomings with their proposed amendments.

BACKGROUND

The Securities Disclosure and Financial Advisers Amendment Bill is described as containing a number of measures aimed at streamlining the raising of capital for New Zealand businesses. In addition, the bill includes minor technical amendments to the Financial Advisers Act 2008.

The bill was referred to the Commerce Select Committee in March 2009 and a short deadline for submissions on the bill was called for by the select committee, reflecting the urgency of the select committee to report back to the House on 30 April. The bill has now passed its second reading and is currently with the Whole House Committee. It is expected to be passed this month.

SECURITIES ACT AMENDMENTS

No changes for the simplified disclosure prospectus regime

One of the core provisions in the bill is the introduction of the simplified disclosure prospectus (SDP) regime to the Securities Act 1978. This will allow NZX-listed issuers who are subject to the continuous disclosure regime to issue a SDP instead of a full prospectus and investment statement for certain specified securities offerings. The SDP will also reduce the level of duplication between forms of disclosure by enabling listed issuers to refer to information previously disclosed under their continuous disclosure obligations, rather than reproducing the information in full.

Submissions in favour of further streamlining of the disclosure regime

The bill only contains minor amendments to the Securities Act to enable the new SDP. Most of the details of the SDP regime, including the scope of the regime and the details of the information to be provided in the SDP, are to be set out in regulations made under the Securities Act. However, the select committee report indicated that there were a number of submissions made on the SDP regime and, in particular, the need to streamline the disclosure regime further.

As the bill stands (but subject to the final form of the regulations), listed issuers are likely to have to undertake the same due diligence process for a SDP offer as they would for any other offer. The SDP will be an advertisement for the purposes of the Securities Act and will be subject to the civil and criminal liability regimes contained in the Securities Act. A full due diligence process will need to be undertaken in order for the listed issuer and its directors to be in a position to take advantage of the defences available under the Securities Act. This would undoubtedly reduce some of the benefits that the new regime is expected to offer.

The report notes that the select committee spent some time considering the proposal that the appropriate test for the disclosure of information under the SDP regime should be in line with the "material information" test under the Securities Markets Act. This would limit the information to be disclosed under the SDP (and the corresponding due diligence required) to the material information relating to the rights and liabilities of the securities being offered and the effect of the offer on the issuer.

However, the select committee was not in favour of this proposition. In its view, the appropriate approach for the SDP is as presented in the bill. The select committee expressed concern over the potential for a gap between all information that is material to new securities being issued, and that which is considered "material information" under the Securities Markets Act, which regulates disclosure in the secondary market.

In the case of a new issue of securities, the select committee considers it appropriate that directors undertake a due diligence investigation to ascertain whether all adverse information has been properly referred to in the SDP, irrespective of the information made available through the continuous disclosure regime. In the select committee's view this is not an onerous requirement "if there are effective processes in place for continuous disclosure".

SDP regulations

A draft of the SDP regulations was released by the Ministry of Economic Development for consultation shortly after the select committee released its report on the bill.

Committee's recommendations to the proposed exemptions from disclosure requirements

The bill also contains amendments to the safe harbour exceptions in section 3(2) of the Securities Act and to the "eligible persons" regime of the Act. Among other minor technical amendments, the select committee has made two noteworthy changes to these aspects of the bill.

Changes to the restrictions of the bill's proposed amendments to section 3(2)(a)

The select committee has recommended that the safe harbour provided by section 3(2)(a) of the Securities Act be amended to provide that an offer of further securities, which is made only to persons who have previously paid a minimum subscription of at least \$500,000 for securities of the issuer in a single transaction, is not an offer of securities to the public to which the prospectus disclosure regime applies, if made within 18 months of the first allotment.

Prior to the select committee's deliberations, this proposed exception included the restrictions that the further securities offered had to be identical to the initial securities offered, and that the offer of further securities must be made within 12 months of the first allotment of the initial securities.

The select committee's amendments to this section will now allow the issuer to utilise a range of different securities to raise further capital from its investors. This is a welcome addition. However, the restriction that the initial investment is to be assessed on one particular investment with the issuer is more limiting than the corresponding safe harbour provided under Australian legislation, which provides for the investor's \$500,000 minimum subscription amount to be assessed on the collective amount invested in the same class of securities with the issuer.

As noted above, the select committee has also recommended extending the period in which an offer of further securities can be made from 12 months to 18 months. The select committee felt that it was appropriate to retain the relatively short timeframe in which the \$500,000 initial investment is to be made, but considered that the 12 month period originally proposed would not give the issuer enough time to complete a full annual reporting cycle and decide whether additional capital needed to be raised. Again this amendment is welcomed, although it is unclear why a restriction to a single financial reporting cycle should be the basis for determining the appropriate time period for this exemption. From a practical perspective, this is still a narrow window of opportunity within which to conduct a "no document" follow-up offer to persons who can only be sophisticated investors, and does not reflect the requirements of either an issuer's need to undertake such capital raisings, nor recognise the ability of the target audience to make their own enquiries prior to subscribing.

Changes to the bill's proposed amendments to the "eligible persons" criteria

The bill's proposed changes to the "eligible persons" criteria were introduced to amend anomalies in the original wording of this provision. The proposed amendments will allow offers of securities to be made to eligible persons, as well as persons who fall within one or more categories of the sub-paragraphs of section 3(2)(a) of the Securities Act (as amended by the bill), without requiring a prospectus or investment statement.

The select committee's recommendations include the insertion of a new sub-clause to the "eligible persons" safe harbour, which requires "experienced" investors to whom an offer of securities has been made to sign a written acknowledgment that they will not receive information usually provided by an issuer making an offer of securities to the public, particularly the investment statement and prospectus. The select committee sees this as a necessary change. Currently, under the Securities Act, an "experienced" investor is only required to acknowledge that an independent financial services provider will not be providing the investor with a prospectus and an investment statement, even though a

financial services provider normally has no obligation to provide an investment statement and prospectus to the investor.

AMENDMENTS TO THE FINANCIAL ADVISERS ACT 2008

The select committee's recommendations include further amendments to the sections of the bill dealing with the Financial Advisers Act (FAA), to remedy errors in that Act that have come to light since the FAA was passed.

Retirement village disclosure statements

The select committee's recommendations have introduced a new clause to the FAA, which clarifies that disclosure statements made by operators of retirement villages under the Retirement Villages Act 2003 do not constitute financial advice for the purposes of the FAA.

Liability and disclosure obligations of employees of qualifying financial entities

The committee's recommendations also introduce further clauses to the FAA to correct the discrepancies in the FAA between the liability and disclosure obligations that apply to an employee of a qualifying financial entity when advising on different types of financial products.

The proposed amendments:

- confirm that disclosure and conduct obligations of authorised financial advisers apply whether or not they are employed or are agents of a qualifying financial entity; and
- clarify that employees and agents of qualifying financial entities who are exempt from registering as financial advisers under the FAA will not be committing an offence when performing a financial adviser service.

Alignment of the Financial Advisers Act with the Financial Service Providers (Registration and Dispute Resolution) Act 2008

The select committee's recommendations have addressed the inconsistency between the registration requirements of financial advisers under the FAA and the Financial Service Providers (Registration and Dispute Resolution) Act. Under the proposed amendment, employees of financial service providers (when operating in their capacity as employees) would not be required to register and belong to a dispute resolution scheme (under the FAA and the Financial Service Providers (Registration and Dispute Resolution) Act) unless the individual was required to register under the FAA.

We're surprised that the extraterritorial "mismatch" apparently intended between the two Acts (which are not currently in force) – refer to our [December 2007 Financial Services Bulletin](#) – has not been implemented here. Perhaps the government has had a change of heart?

A MISSED OPPORTUNITY?

The select committee has chosen to sideline some useful submissions on the bill that would have addressed a number of known issues with the Securities Act. This includes missing other "safe harbour" opportunities from the disclosure requirements of the Securities Act, particularly those that could have accommodated small-scale offerings by SMEs at a time when they need it most. It is also unlikely that the new SDP regime will live up to its promise to make a significant difference to the time and costs associated with securities offerings for listed issuers, given that there will still be a need for extensive due diligence under the new regime.

The government has promised to undertake a wider review of the Securities Act later this year. We hope to see the submissions on the bill addressing some of the wider problems with the Securities Act being taken up as part of this review.

Insurance (Prudential Supervision) Bill

Released on 20 April 2009, the Insurance (Prudential Supervision) Bill proposes the introduction of limitations on statutory funds.

Life insurers may not mortgage or charge any assets of a statutory fund except to secure a bank overdraft (clause 90(3)).

There are also restrictions on unsecured borrowings (clause 90(4)) and restrictions on giving guarantees (clause 90(6)).

These restrictions will need to be considered by life insurers in the context of their current and proposed financing arrangements.

In the journals

Enforcement of security interests: a general guide to interpreting New Zealand's system of overlaying statutes

Roger Fenton, Company and Securities Law Bulletin, February 2009

This article considers the jurisdictional mix created by the four statutes governing the enforcement of security interests in New Zealand.

The author's observation that "2009 seems likely to be a vintage year for the enforcement of security interests over personal property" has led him to write this selective review of the four statutes applicable to enforcement of security interests. It is, in Dr Fenton's words, a selective, rather than comprehensive, review, intended to assist the general practitioner rather than the specialist with day-to-day experience of insolvency matters.

Mercury Tax Group v HMRC and the importance of 'execution formalities'

David Fricker and Liz Saxton, *Butterworths Journal of International Banking and Finance Law*, March 2009, 158

A recent English case serves as a useful reminder of the importance of the so-called 'execution formalities' applicable to the signing of legal documents.

The case¹ concerned a tax consultancy company (MTG) that operated a tax avoidance scheme for its clients, which was lawful if it was properly implemented. HM Revenue & Customs (HMRC) suspected the scheme was being dishonestly implemented by MTG.

It turned out that, rather than sending out final versions of the relevant documents to be signed, MTG arranged for clients to sign drafts and, at a later date, would transfer the signed pages into the final versions (without explicitly seeking consent from, or informing, its clients). The final versions also contained blanks into which details were manually inserted by MTG after completion, purportedly on behalf of its clients (but without their knowledge).

The decision

Finding the document invalid, the judge stated that he was not convinced by the submissions that:

- adding signature pages from an earlier draft to the final version of a document constituted a lawful amendment of the draft document by MTG on behalf of its clients; and
- MTG had implicit authority from its clients to insert the details into the documents on the basis that the client must have envisaged that these blanks would be completed, and that the words inserted fell within the scope of what the client would reasonably have expected to be inserted.

The court held:

- there was no evidence to establish any express or implied authority from the client to alter the documents;
- there was no general authority to suggest the legitimacy of 'the taking of a signature page from one document and its recycling for use in another document';
- the parties to any written contract must be taken to have regarded the signature of the contract to be an essential element in determining its effectiveness and consequently 'the common understanding is that the document to be signed exists as a discrete physical entity (whether a single version or in a series of counterparts) at the moment of signing';
- the requirement that the parties sign 'an actual existing authoritative version of the contractual document' is important in order to protect against fraud or mistake; and
- if the document in question had been a deed, the legal requirements for the proper execution of deeds would not have been complied with.

The judge concluded that 'a strict test of formality' must always be applied.

Author's perspective

The author noted that the context of the case was unusual and may therefore be distinguished by future cases because the validity of the contract was challenged by a third party rather than a party to the contract.

However, if the approach taken by the court in this case is followed in other cases, it appears that:

- the courts will apply a strict and restrictive interpretation of the rules applying to execution of documents;

¹ *Mercury Tax Group v HMRC* [2008] EWHC 2721 (Admin)

- any practice involving execution by any party of anything other than the final version of a contract carries the risk of that contract being invalid; and
- if blanks in documents are to be completed on behalf of the parties to a contract, clear authority to do so must exist.

This case serves as a timely reminder that care must be taken on the execution of a contract. In particular, the attaching of a signature to a document where that signature has come from anything but the agreed final version, or any practice of filling in blanks after the event without clear authority, may well undermine the validity and enforceability of that document.

Re Octaviar Ltd: unsettling implications for secured financings

M Lovell, *Australian Banking and Finance Law Bulletin* (2009, Vol 24 No 9)

This article concerns an Australian case about registration of variations to registered charges.

Although the case¹ is Australian, it has implications for New Zealand lenders who have Australian-based security providers.

A fixed and floating charge was granted by an Australian company to secure a loan to the company's subsidiary. The charge secured all money, obligations and liabilities of the borrower to the financier "under or in relation to a transaction document". The definition of "transaction document" allowed the financier, the borrower and security provider to designate any other document as a Transaction Document for the purposes of the loan agreement.

Several months after the charge was granted, the parties agreed in writing to designate an existing guarantee as a Transaction Document so that it would become secured by the existing charge. No amendment was made to the charge itself.

Section 268(2) of the Australian Corporations Act provides that where, after a charge has been created, the terms of the charge are varied so that the amount of the debt or liabilities secured by the charge are increased, a notice of that variation, and the instrument effecting the variation, must be lodged with ASIC within 45 days.

The Public Trustee (as trustee for certain noteholders) argued that the designation of the guarantee as a "transaction document" varied the charge and increased the liabilities secured by it. Therefore, as no notice had been given, the charge was void as security against an administrator to the extent that it secured the guarantee.

The court agreed with this argument and ruled that the charge was void as security to the extent that it secured the liability of the security provider under the guarantee.

The author expects that this decision will be appealed. In the interim, it is suggested that lenders with Australian security review any existing charges that:

- secure amounts owing under specified documents; and/or
- allow the parties to broaden the liabilities secured by way of designating additional finance documents or transaction documents.

If there have been changes to the financing arrangements that have increased the liabilities owed, then the lender should ensure that ASIC is notified.

¹ *Octaviar Ltd, Re; Re Octaviar Administration Pty Ltd* [2009] QSC 37; (2009) ACSR 621

Recent developments

An update on corporate governance in the wake of the credit crisis

A number of recent reports have identified deficiencies in the corporate governance practices of many failed companies. These findings include deficient risk management practices, weaknesses in board composition and the failure of non-executive directors and shareholders to effectively monitor decisions of the board.

Partner Andrew Brown and solicitor Sophie Gladwell take a closer look at some of these reports and highlight some key findings for New Zealand companies' corporate governance practices.

RESEARCH HIGHLIGHTS POOR CORPORATE GOVERNANCE PRACTICES

Since the Enron scandal in 2001, there has been an increased awareness of the significance of corporate governance, and the role it plays in ensuring a company's accountability, legal compliance, stakeholder relationships and performance.

It is therefore not surprising that the current credit crisis has led to a new focus by regulators, shareholders and others on poor corporate governance practices in search of answers to the recurring question: how could it all have gone so wrong?

Attention has been particularly focused on executive remuneration practices, which are widely thought to have encouraged excessive risk taking, as one key area of corporate governance requiring reform. In February 2009, new guidelines were introduced in the United States, restricting executive pay for companies receiving government financial assistance, and a range of reform proposals are currently under consideration in Australia¹ to address executive remuneration issues. Similar concerns and developments are evident in Europe and Asia.

However, remuneration policies are not the only corporate governance issues being linked to the current economic crisis and company failures. Deficient risk management practices, weaknesses in board composition, and the failure of non-executive directors and shareholders to effectively monitor and scrutinise the decisions of boards are also being highlighted as key areas requiring reform to avoid future failures.

Risk management

The global financial crisis has been a salutary reminder of the importance of risk management at all levels of an organisation. The OECD published a report in February 2009 ("*The Corporate Governance Lessons from the Financial Crisis*") which concludes that the crisis can:

"to an important extent be attributed to failures and weaknesses in corporate governance arrangements which did not serve their purpose to safeguard against excessive risk taking in a number of financial service companies."

The report primarily examines the banking sector, and significant events involving banks such as UBS, Société Générale and Bear Stearns, and suggests that in some circumstances, information concerning risk was used inadequately.

¹ Australia is proposing to introduce amendments to the Corporations Act 2001 (Cth) aimed at curbing what it terms 'excessive golden handshakes' or termination payments paid to departing company executives. It has also directed the Productivity Commission to undertake an inquiry into the current Australian regulatory framework around executive remuneration.

The report notes that less effective boards were unaware of strategic decisions being made by management and had not implemented an effective mechanism to enable the board to oversee the bank's risk appetite. In addition, certain boards had a limited technical understanding of products (such as mortgage-backed securities) and a lack of control over balance sheet growth and liquidity needs.

The lack of an active risk committee was cited as another possible reason for ineffective risk management, as Lehman Brothers' risk committee was noted as meeting only twice (in 2006 and 2007) and Bear Stearns' committee was formed just before it collapsed.

The report also identifies the inferior prestige and status afforded to risk management staff as a possible contributing factor. For example, Société Générale informed its shareholders of an "imbalance...between the front office, focused on expanding its activities, and the control functions which were unable to develop the critical scrutiny necessary for their role". The US Securities and Exchange Commission (SEC) recognised that one feature of Bear Stearns' failure was that staff involved in risk worked in close proximity to traders, which suggested to the SEC that risk managers suffered a lack of independence.

The report also acknowledged that although rating agencies, disclosure and accounting standards played a role in causing the credit crisis, the best boards were able to use their own powers to overcome the weaknesses and associated risks in these areas. Effective boards had implemented systems that led to the efficient sharing of information, and open dialogue across management and the board.

Board composition

In New Zealand, the most glaring example of failures in corporate governance has been in the finance company sector. A recent report issued by the Registrar of Companies to the Ministry of Economic Development² highlights board composition and the competence of directors as key factors which contributed to the collapse of 29 finance companies in New Zealand over the last two years.

The report notes that the boards of these finance companies tended to lack the breadth of experience and skills required to oversee the scale, complexity and characteristics of financing operations. It also points out that several of the companies were led by a dominant chief executive who was the "principal architect of the company's modus operandi". Further, a pattern was recognised where several directors had previously been involved in finance industry failures. The new Non-Bank Deposit Taker rules should help to address this shortcoming through prescribed corporate governance standards and "fit and proper" checks for senior management.

The Registrar also criticised a raft of behaviour exercised by the boards of these companies. The report states that "too often directors were not adequately informed, misled or failed to take sufficient interest in the affairs of the company". It also identifies instances of excessive related party lending, the adoption of practices that masked the true performance of loan portfolios, and the use of funds received for investment from new investors being used to repay the maturing loans of existing investors.

Non-executive directors and shareholder passivity

The UK Treasury published a report on the banking crisis in May 2009 ("*Banking Crisis: reforming corporate governance and pay in the City*") which states that "banks have failed because those leading and managing them failed"³. The UK Treasury quotes PIRC, a leading UK corporate governance consultancy, which accuses boards of being primarily responsible for the failure of banks because they "approved the business strategies and products that have caused such damage".

The UK Treasury has highlighted a failure of non-executives to fulfil their role of effectively overseeing and acting as a check on executive directors, and the UK Treasury suggested that some boards "operate

² 2007/08 financial review of the Ministry of Economic Development, Report to the Commerce Committee (dated 19 March 2009)

³ Banking Crisis: reforming corporate governance and pay in the City.

<http://www.publications.parliament.uk/pa/cm/cmtreasy.htm> HM Treasury's report examined and made recommendations for change in areas such as corporate governance, remuneration and the roles of credit agencies, auditors, the media and accounting standards.

as members of a 'cosy club'". In order to address the current failings of non-executives, the UK Treasury has suggested some areas for reform:

- to limit the number of non-executive directorships that an individual can hold;
- to require non-executives to have a relevant professional qualification to sit on the board;
- to broaden the talent pool from which the banks can draw upon in appointing non-executives; and
- to examine ways in which the relationship between institutional shareholders and non-executives can be strengthened.

Institutional shareholders have also been accused of failing in their task of scrutinising and monitoring the decisions of boards. While the UK Treasury suggests that further consideration should be given to reform in this area, PIRC has subsequently suggested that the problem may not be the corporate governance framework or mechanism itself, "but the failure of some shareholders to use the rights they have effectively"⁴.

IMPLICATIONS FOR NEW ZEALAND

With the global spotlight on corporate governance practices and the likelihood of increased government scrutiny of corporate conduct on the horizon, it is an opportune time for New Zealand companies to assess the effectiveness of their own corporate governance practices.

The New Zealand Securities Commission has already announced that it will review the corporate governance disclosure practices of selected listed issuers as part of its ongoing financial reporting surveillance programme. In making this announcement, the commission's chair, Jane Diplock, noted that there was a need for "greater assurance that issuers have robust corporate governance arrangements in place" in the current financial climate.

The starting point for any corporate governance review will be based on New Zealand's own approach to "best practice" in corporate governance, as envisioned by company law, the NZX's Corporate Governance Best Practice Code, and the Securities Commission's set of nine principles entitled *Corporate Governance in New Zealand – Principles and Guidelines*. Together, these provide a comprehensive framework for companies to develop sound corporate governance practices.

However, New Zealand companies should also be mindful of the recent corporate governance issues being highlighted in other jurisdictions. Some of the key themes on corporate governance practices arising out of the reports noted above and other overseas studies include the following:

- Boards should ensure they have access to all relevant information. This includes ensuring that there are appropriate systems of control in place - in particular for risk management, financial and operational control, and compliance with the law.
- Companies should consider re-emphasising the roles of the CEO and the board in the risk management process so that they can properly oversee, monitor and have a forward looking perspective of risk issues. In addition, boards should consider having separate risk and audit committees.
- Boards should ensure that, when an independent director is selected, the focus is not only on independence and objectivity but also on capabilities. This may include acquiring appropriate skills upon appointment, and ensuring they keep up-to-date with relevant laws, regulations and changing risks through in-house and external training.
- Participation of non-executive directors should be encouraged. For example, if directors have not had sufficient experience of the specific market in which the company operates, as their experience comes from other arenas, the relevant directors should be given market specific training, enabling them to be aware of the relevant risks, and apply the corporate governance principles to their company.

For further details on New Zealand's corporate governance requirements and how to improve practice and procedure, please feel free to contact your usual Bell Gully adviser.

⁴ <http://www.pirc.co.uk/news/story336.html>

New Zealand's Emissions Trading Scheme – still up in the air?

In this article, partner [Simon Watt](#) and senior associate [Kate Radka](#) discuss the likely outcome for New Zealand's Emissions Trading Scheme in the light of its current review and recent economic events.

New Zealand's Emissions Trading Scheme (NZ ETS) remains under review. While the government awaits the findings of the NZ ETS Parliamentary review committee, trading of New Zealand's Kyoto-compliant units is already underway.

The government expects to amend the scheme by September 2009. We believe the framework is most likely to remain in place. However, it is possible in the current economic climate, and in light of the volatile carbon market, that the government may implement measures to provide greater financial protection for business.

Outline of the NZ ETS

The NZ ETS is an economy-wide, all-gases scheme. Participants with compliance obligations must surrender emission units equivalent to all emissions calculated to arise from specified activities. Participants carrying out one of the limited removal activities specified in the Climate Change (Emissions Trading) Amendment Act (the Act) will be awarded units for emission reductions.

The primary unit of trade and compliance under the NZ ETS is a New Zealand Unit (NZU). Each NZU is backed by a Kyoto-compliant unit, primarily an Assigned Amount Unit (AAU). NZUs may be traded internationally, in which case they would be converted into AAUs. The following Kyoto-compliant units may also be traded and surrendered under the NZ ETS:

- Certified Emission Reduction Units (CERs) – except CERs from nuclear projects and ICERs from developing countries;
- Removal Units – although in reality this is unlikely to occur;
- Emission Reduction Units (ERUs); and
- AAUs – although AAUs originating outside of New Zealand may only be used for compliance purposes until 2012, and must be of a type specified in regulations (which have yet to be released but are likely to have an associated environmental integrity requirement).

Future international linking with other emissions trading schemes is foreshadowed in the Act by the inclusion of "approved overseas units" as a type of unit that may be surrendered for compliance purposes in the Act.

A relatively unique feature of the NZ ETS is that emission units allocated to forestry owners under the scheme can be exchanged and interchanged like any other non-forestry NZU, and are available for trading and for compliance use on the same basis. Unlike ICERs and tCERs, awarded for emission reductions arising from forestry-related Clean Development Mechanism projects, any NZUs or AAUs allocated or awarded to forestry owners will not be temporary in nature.

The government's review and trans-Tasman harmonisation

While the NZ ETS framework is most likely to remain in place, it is possible that the government may introduce measures to provide greater financial protection for business, notably around the price of carbon, by providing for a price cap or a greater allocation of free units to specific industries.

This would also assist with aligning the NZ ETS and the proposed Australian Carbon Pollution Reduction Scheme (CPRS) in future. It is no secret that the New Zealand and Australian governments continue to discuss this as a possibility, particularly with the recently established joint working group of Australian and New Zealand officials to work through options for harmonising the NZ ETS and CPRS. If the findings of this group are adopted, they could significantly alter the NZ ETS.

Specific areas most likely to be the focus of change for harmonising the schemes are the inclusion of a price cap, aligning the types of units acceptable to trade in the schemes, the method for allocating free

units to trade-exposed industry, and the timing of sector entry into the schemes. Judging by Australia's recent announcements further delaying the CPRS to mid-2011, with a proposed price cap of AU \$10 for the first year, and for New Zealand not to expect any particular "special" treatment over other countries, any alignment of the schemes is unlikely to occur prior to 2013.

International trading

International trading is recognised and permitted by the NZ ETS. There is no restriction under the current form of the Act on the number of units that may be traded internationally (subject to the requirement not to breach the compliance period reserve, which ensures New Zealand retains sufficient AAUs to be able to meet its own Kyoto obligations). We expect a number of units to be sold internationally as participants look to trade with international entities to obtain sufficient units for compliance purposes at the end of each annual compliance period.

To date, there has been some selling by New Zealand to international entities, including both ERU and AAU trades, and New Zealand entities have also been in discussions with Eastern European entities to acquire Green Investment Scheme AAUs.

Early ERU trades have arisen from the government's Projects to Reduce Emissions (PRE) tender rounds in 2003 and 2004. The PRE programme was designed to support initiatives that would reduce emissions and attract investment from developed countries, or companies within those countries, on projects that help them meet their greenhouse gas emission reduction commitments. There are 40 projects in the PRE scheme resulting in the following ERU trades:

- Dutch government agency SenterNovem acquired 530,000 ERUs from the Te Apiti Wind Farm.
- Swiss industry initiative Climate Cent Foundation acquired 642,469 ERUs from Project White Hill.
- Electrabel S.A. acquired 228,000 ERUs from Tararua Wind Farm Stage II.
- Kansai Electric Power Co. Inc. acquired 300,000 ERUs from Tararua Wind Farm Stage III.
- British Gas Trading Ltd acquired 200,000 ERUs from the Burwood Landfill Gas Utilisation Project.
- Kommunalkredit Public Consulting GmbH acquired 149,006 ERUs from the Awapuni LFG to Energy Project.
- Barclays Capital PLC acquired 300,000 ERUs in the Putauaki Geothermal Development.

A number of New Zealand and Japanese entities have been negotiating the acquisition of AAUs, primarily from New Zealand forestry participants in the NZ ETS or in the Permanent Forest Sink Initiative.

The first trade of post-1989 NZUs involved the forward sale of 50,000 NZUs at NZ \$20 (approximately 9 Euros) per unit. We are expecting the finalisation of other NZU and AAU trades to both domestic and international entities shortly.

Fiscal initiatives

The NZ ETS contemplates a number of fiscal initiatives to assist with the transition to the NZ ETS, including the free allocation of units to the forestry and agricultural sectors, as well as to trade-exposed entities (although only for the proportion of their production which is trade exposed), with a phase-out of free allocation to the agricultural sector and trade-exposed entities expected to start in 2018.

There are also some more unique fiscal initiatives to New Zealand that have been, or may be, introduced by the government, including:

- The NZ ETS legislation created a fund to promote energy efficiency and renewable energy technologies in the home. A total of NZ \$1 billion has been allocated over the next 15 years, starting next month. The details of the programme have not been finalised yet, but the Act states that the fund can be used for household insulation, energy efficient appliances and lighting, and space and water heating efficiency improvements. Already, we have seen the introduction of government funding for the insulation of homes, and expect further initiatives to be developed throughout the year.
- New Zealand's unique emissions profile is heavily skewed towards agricultural-based emissions (agricultural greenhouse gases make up at least 49% of New Zealand's total emissions). In recognition of the difficulties in abating such emissions and the need to address abatement in this area, an agricultural research and development fund has been established, with the aim of driving research and development of technological solutions for agricultural emission abatement.

Businesses have been lobbying the government for further Projects to Reduce Emissions (PRE) tender rounds (as discussed above), which would incentivise the development of more emission reduction projects. Until now, the government has been reluctant to introduce further PRE rounds, as a result of the projected deficit for 2012. However, with the recent announcement that New Zealand is estimated to have a 9.6 million tonnes surplus at the end of 2012 – worth an estimated \$241 million, there is a real possibility that the government may revisit the PRE programme, and instigate another tender round for PRE projects.

Pre-1990 forestry deadlines looming

Pre-1990 foresters (including farmers and other landowners with pre-1990 forests on their land) have important decisions to make in light of the looming deadlines in the next couple of months.

With the Act continuing to be in effect, despite the review taking place, those with pre-1990 forests who wish to apply for an under 50 hectare exemption (where they are eligible to do so) must do so by 30 June 2009. For those who do not apply for an exemption from deforestation liabilities, or are not eligible to do so, an application for the one-off allocation of units for pre-1990 forests must be filed by 31 July 2009.

A failure to apply for an exemption (where eligible) could expose a pre-1990 forester to approximately \$20,000 in compliance costs per hectare (assuming a price of carbon of \$25 a unit) for deforestation of that pre-1990 forest. Similarly, for those who determine the commercial risk to be low and do not apply for the exemption, or are not eligible for an exemption, then a failure to apply for the one-off allocation for their pre-1990 forest could cost them the opportunity to receive around \$975 to \$1,500 per hectare worth of units (again, assuming a carbon price of \$25 per unit and depending on the date on which they acquired the forest).

There is a possibility that the government will push out one or both of the June or July 2009 deadlines as a result of the delayed reporting from the NZ ETS review committee. However, this is yet to have been determined by the government and foresters should continue to work towards the first deadline of June 2009.

Bell Gully news

[Big brain gain for Bell Gully senior associate ranks](#)

Talented New Zealand lawyers practising in Europe and Australia have returned to Bell Gully's senior associate ranks, bringing home a collective 40 years' international experience.

[Bell Gully advises Fisher & Paykel Appliances on equity raising](#)

Bell Gully has advised Fisher & Paykel Appliances Holdings Limited on its fully underwritten \$189 million equity raising, including the introduction of a new cornerstone shareholder, as well as the company's \$575 million debt refinancing.

[Delivering New Zealand's nationally critical projects](#)

Ways to ensure delivery of nationally important major projects have been on the agenda at an environmental and resource management conference in Auckland.

[Bell Gully collects deal team award](#)

Bell Gully's work on the country's significant deals of 2008 saw its corporate practice named the New Zealand Deal Team of the Year at Australasia's premier legal awards.

[Inspiring lawyer and leader named CLANZ-Bell Gully Young Corporate Lawyer of the Year](#)

A lawyer described as an inspiration to all corporate counsel is the winner of the 2009 CLANZ-Bell Gully Young Corporate Lawyer of the Year Award.

[Bell Gully climate change deal finalist for Australasian law awards](#)

The world's first ever carbon deal for avoided deforestation has been shortlisted for the Energy & Natural Resources Deal of the Year at this year's ALB Australasian Law Awards.

[Maori land and governance](#)

A recent Maori Land Court decision indicates that the court is becoming more definitive about governance standards required in commercial dealings, suggests senior solicitor Tama Potaka.

[Minister appoints Bell Gully partner to government overseas investment advisory group](#)

Bell Gully partner Andrew Petersen has been appointed to an expert advisory group charged with advising on the review of New Zealand's overseas investment rules.

[Chambers global names Bell Gully New Zealand market leader](#)

Bell Gully has topped the New Zealand law firm rankings for the sixth consecutive year in leading international legal publication Chambers Global.

[Legal launch a first for New Zealand](#)

New Zealand's legal landscape has gained a major new resource with the launch of the country's first practice manual for lawyers working in-house in the private and public sectors.

Useful Web links

New Zealand government

- [Consumer Affairs](http://www.consumeraffairs.govt.nz) [www.consumeraffairs.govt.nz]
- [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]
- [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]
- [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]

New Zealand financial 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]
- [Export Credit Office](http://www.nzeco.govt.nz) [www.nzeco.govt.nz]
- [NZ Law Commission](http://www.lawcom.govt.nz) [www.lawcom.govt.nz]
- [Office of the Banking Ombudsman](http://www.bankombudsman.org.nz) [www.bankombudsman.org.nz]
- [Office of Insurance and Savings Ombudsman](http://www.iombudsman.org.nz) [www.iombudsman.org.nz]
- [Office of the Privacy Commissioner](http://www.privacy.org.nz) [www.privacy.org.nz]
- [Personal Property Securities Register](http://www.ppsr.govt.nz) [www.ppsr.govt.nz]
- [Reserve Bank of New Zealand](http://www.rbnz.govt.nz) [www.rbnz.govt.nz]
- [Securities Commission](http://www.seccom.govt.nz) [www.seccom.govt.nz]
- [Takeovers Panel](http://www.takeovers.govt.nz) [www.takeovers.govt.nz]

New Zealand commercial sites

- [CLANZ](http://www.clanz.org) [www.clanz.org]
- [Financial Services Federation](http://www.fsf.org.nz) [www.fsf.org.nz]
- [Institute of Chartered Accountants](http://www.nzica.co.nz) [www.nzica.co.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]
- [NZ Exchange](http://www.nzx.com) [www.nzx.com]

Australian government sites

- [Banking Ombudsman](http://www.abio.org.au) [www.abio.org.au]
- [National Office for the Information Economy](http://www.noie.gov.au) [www.noie.gov.au]

Australian commercial 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

- [Bank for International Settlements](http://www.bis.org) [www.bis.org]
- [Global Banking Law Database](http://www.gbld.org) [www.gbld.org]
- [International Monetary Fund](http://www.imf.org) [www.imf.org]
- [International Swaps and Derivatives Association](http://www.isda.org) [www.isda.org]
- [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]
- [World Bank](http://www.worldbank.org) [www.worldbank.org]