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Consumer credit law reform - what do you need to do?

In the next few issues of *Financial Services Quarterly*, we will guide you on what you should be doing, and by when, to ensure you're ready when the new legislation takes effect in April next year.

Welcome to the third issue of Financial Services Quarterly, a review of current legal issues in the financial sector from Bell Gully.

Each quarter, we summarise recent issues and preview upcoming developments.

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In the courts

If a bank suspects a breach of trust, can it refuse to carry out its customer's instructions?

The Court of Appeal has considered the duty of a banker faced with a customer's demand for payment of an account in credit when the bank had become aware that payment might constitute a breach of trust in relation to a third party.

When can a bank avoid paying under an irrevocable letter of credit?

The Australian Supreme Court has decided that there are at least three circumstances where a bank does not have to pay.

At what point is a mortgagor's right to redeem lost?

The High Court has considered a mortgagor's right to redeem, and when that right is extinguished.

Is it a guarantee or is it an indemnity?

A guarantor's arguments that the "deed of indemnity and right to mortgage" that he had signed was a guarantee and not an indemnity and that a variation to the original contract relieved him of liability were rejected by the High Court.

A reminder of the distinctions between a guarantee and an indemnity is set out following the summary of this case.

Edgewater distinguished: GST is not payable to the IRD before repayment of a mortgage where the sale is not a mortgagee sale

The Court of Appeal distinguished the decision in *Edgewater* (referred to in the Winter 2003 issue of *Financial Services Quarterly*) on the basis that the sale in this case was made by the mortgagor, and not the mortgagee.

Ordinary resolution for sale of Fletcher Challenge Forests' forest estate

In December last year, the High Court ruled that Fletcher Challenge Forests Limited (FCF) only had to put an ordinary resolution to shareholders with a 50 per cent vote, rather than a special resolution with a 75 per cent vote, when forest assets owned by its subsidiaries are sold.

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In the courts

If a bank suspects a breach of trust, can it refuse to carry out its customer's instructions?

This case¹ considered the duty of a banker faced with a customer's demand for payment of an account in credit when the bank had become aware that payment might constitute a breach of trust in relation to a third party.

The appellant had two accounts with the bank – "Balmoral Supermarket" and "US International".

The appellant's sole director drew a bank cheque against the US International account and offered it for the benefit of creditors of his supermarket business in an attempt to stave off liquidation. When his attempt was unsuccessful, the appellant re-banked the cheque into the US International account.

The court-appointed liquidator phoned the bank to inform it of his appointment. A letter from the liquidator's solicitors was subsequently sent to the bank claiming that the amount of the bank cheque was funds of the company in liquidation, advising that application was being made to freeze those funds, and requesting that they be frozen pending the outcome of the application.

The bank froze the US International account and when the appellant tried to operate his accounts it was evident that bank employees thought that all his accounts were frozen.

The appellant met with a bank employee and subsequently wrote to the bank advising that:

- the US International account had nothing to do with the Balmoral Supermarket account;
- he had to make a payment out of the US International account and that failure to do so would result in considerable loss for which he would hold the bank responsible; and
- the freeze on the accounts should be lifted.

An order was subsequently made for the funds to be paid into court (but a few months later the order was discharged by consent).

The High Court decided that the bank was not liable for refusing to pay funds in US International's account as directed by US International.

The Court of Appeal did not agree with the High Court decision and, in allowing the appeal, decided that:

- a bank has a fundamental obligation to comply with its customer's instructions but is entitled not to if it would be dishonest to do so; and
- applying the "dishonesty" test, the bank did not justify its refusal to carry out the instructions in this case.

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¹ *US International Marketing Limited v The National Bank of New Zealand Limited* (Court of Appeal CA 144/02, 28 December 2003, Tipping, Anderson & Glazebrook JJ)

In the courts

When can a bank avoid paying under an irrevocable letter of credit?

It is an essential characteristic of a letter of credit that it is an autonomous contract, and that its performance is independent of the underlying transaction to which it relates. So, when can a bank avoid paying under an irrevocable letter of credit?

The judge in this Australian Supreme Court case² concluded that there are at least three circumstances where a bank does not have to pay:

- in the case of fraud;
- where it is clear from the underlying contract that there would be no call on the credit where there was a bona fide dispute; or
- where there was unconscionable conduct under certain sections of the Trade Practices Act (which are broadly similar to sections 9 and 11 of the Fair Trading Act 1986 of New Zealand).

Fraud

The first exclusion was not relevant to this case.

Negative stipulation

The court did not agree that the second exclusion was applicable in this case, but noted that English courts have expressed strong reluctance to exercise it. This is because although restraining the beneficiary from breaching the underlying contract does not directly interfere with the autonomy of the payment obligation, the effect of intervening is to break down the separation between the underlying contract and the independent financing contract. However, the court noted that there is a solid line of authority in Australia for the view that an injunction is available in such circumstances.

(We note that New Zealand courts appear to be taking their lead from English decisions, rather than following Australia, in this regard).

Unconscionable conduct

In this case, there was a dispute as to amounts owing to the supplier. Notwithstanding the dispute, the beneficiary provided to the bank a certificate representing that the full amount was due. It also certified that demand for payment had been made and had remained unsatisfied.

The court decided that the conduct of the beneficiary was unconscionable within the meaning of section 51AC of the Trade Practices Act because the amount referred to in the certificate was false, and the statement about demand was misleading (in fact demand was made on the same day as the certificate).

The wording in the Trade Practices Act is broadly consistent with New Zealand's Fair Trading Act and therefore it is possible that the analysis used in this Australian decision could equally apply to a similar case in New Zealand under the Fair Trading Act.

Construction of the letter of credit

Finally, the judgment contains some interesting observations on the construction of the relevant document, notably:

- Where a letter of credit is expressed to be "irrevocable", but not "unconditional", the court is open to adopt a construction that there are conditions to payment (but they need to be specifically recorded).
- Where the instrument is a bank guarantee, under which a bank "unconditionally" undertakes to "pay on demand", the court will adopt a construction of the instrument that reflects the unconditional nature of the payment obligation, and will not make the bank's payment obligation dependent on the claimant establishing an entitlement to be paid.

² *Boral Formwork & Scaffolding Pty Limited v Action Makers Limited (In Administrative Receivership) & Anor* [2003] NSWSC 713

- A standby letter of credit provides for payment by the financier on receipt of documents, rather than simply on demand. Whether a standby letter of credit should be construed in the same fashion as a bank guarantee or performance bond depends on the commercial purpose of the instrument.

The court contended that it is theoretically possible, though highly unlikely, that, in a case where the purpose of a letter of credit is nothing more than to provide security for payment of valid claims, the financier's obligation to pay might depend on its being satisfied that the beneficiary has a valid claim against the account party for the amount called. However, standby letters of credit are more typically in the nature of a bank guarantee intended to shift the credit risk, rather than to provide security for payment.

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In the courts

At what point is a mortgagor's right to redeem lost?

In this case³, the court considered a mortgagor's right to redeem, and when that right is extinguished.

Following the mortgagor's failure to repay the loan when due, the mortgagee auctioned the mortgaged property and entered into an agreement for sale of the property to the mortgagor. It also entered into a back-up agreement for sale to a third party at a lower price. The mortgagor failed to settle the purchase, resulting in the mortgagee cancelling the contract and pursuing the contract with the third party.

The mortgagor sought an injunction restraining the mortgagee from settling the contract with the third party on the grounds that:

- it had a right to redeem the mortgage pursuant to section 81 of the Property Law Act 1952; or
- alternatively, the mortgagee breached its duty of care owed to the mortgagor to obtain the best price reasonably obtainable for the property.

When is a mortgagor's right to redeem extinguished?

Section 81(1) of the Property Law Act states:

"A mortgagor is entitled to redeem the mortgaged land at any time before the same has been actually sold by the mortgagee under his power of sale, on payment of all money due and owing under the mortgage at the time of payment".

The meaning of the words "actually sold" was considered in this case, and the court followed *Howson v Little*⁴ in determining that a conditional sale is an actual sale for the purposes of section 81(1). Accordingly, the mortgagor's right to redeem was lost when the conditional contract was entered into with the third party.

What about the duty to obtain the best possible price?

The court noted that a mortgagee has a duty in exercising its power of sale to take reasonable care to obtain the best price reasonably obtainable as at the time of sale pursuant to section 103A of the Property Law Act and to the decision in *Apple Fields Limited v Damesh Holdings Limited* (referred to in the Spring 2003 issue of *Financial Services Quarterly*).

However, conceding that it was strongly arguable in this case that the mortgagee was in breach of its duty, the court decided that such a breach does not go to the question of the mortgagee's right to sell, but only to the amount obtained as a result of that right that can be compensated for by an award of damages.

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³ *Bhana v Westpac Banking Corporation* (High Court, Auckland CIV-2003-404-4520, 10 September 2003, Venning J)

⁴ [1948] NZLR 1073

In the courts

Is it a guarantee or is it an indemnity?

In this case⁵, the defendant argued that the "Deed of indemnity and right to mortgage" that he had signed was a guarantee and not an indemnity. The defendant also argued that a variation to the original contract relieved him of liability. Both arguments were rejected by the court.

The first argument was made on the basis that the relevant clause referred to loss, and not to payment of the principal debt. As loss would only occur on non-payment by the principal debtor, the defendant argued that his liability was secondary, and therefore was a guarantee and not an indemnity.

The court found that the plain meaning of the deed was to safeguard the lender against loss and that the parties had spoken of indemnity and not of guarantee.

The defendant further submitted that a variation of the loan agreement constituted a departure by the lender from the principal contract without the guarantor's consent, which relieved him from liability. However, the court restated that "a contract of indemnity is not affected by a variation of the principal debtor's obligations"⁶.

Notwithstanding this, in order to avoid any argument, it is always prudent to ensure that any guarantor or indemnifier consents to any amendment to the terms of the guaranteed or indemnified contract.

Distinctions between guarantees and indemnities
• An indemnity is a promise that "I will see you are paid"
• A guarantee is a promise that "If he does not pay you, I will"
• A guarantee generally arises on the default of the borrower, and is secondary to the main agreement
• An indemnity is a primary obligation that is a distinct, autonomous undertaking not dependent for its content or enforceability on the terms or validity of the undertaking given by the borrower to the lender
• An indemnity provides a significantly more robust undertaking from a lender's perspective

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⁵ *NZHB Holdings v Peters* (High Court, Auckland CP348-SD02, 20 August 2003, Baragwanath J)

⁶ *Nathan Finance Limited v Martin Simmons Airconditioning Services Limited* (High Court, Auckland A1019/85, 17 December 1986, Wylie J)

In the courts

Edgewater distinguished: GST is not payable to the IRD before repayment of a mortgage where the sale is not a mortgagee sale

In this case⁷, the Court of Appeal distinguished the decision in Edgewater⁸ (referred to in the Winter 2003 issue of Financial Services Quarterly) on the basis that the sale in this case was made by the mortgagor, and not the mortgagee.

The director of a GST-registered company voluntarily sold a property for less than what was due under the mortgage and, between the sale becoming unconditional and settlement, the company went into liquidation.

The liquidators sought directions from the High Court as to whether they should retain the GST portion of the purchase price and pay it to the IRD or whether all net proceeds should be paid to the mortgagee with the liquidators to account for GST on the total inputs/outputs for the GST period in due course.

The High Court held that all proceeds of sale should be paid to the mortgagee, and the Court of Appeal dismissed the liquidators' appeal, deciding that:

- the GST liability arose prior to liquidation, and the liquidators had no personal responsibility for it under section 58 of the Goods and Services Tax Act 1985;
- there was no new replacement supply when the liquidators chose to complete the sale;
- the "GST sum" was a portion of the purchase price and not received as payment of GST; and
- there was no provision in the Goods and Services Tax Act that applied where there was no mortgagee sale. Instead, section 98(2) of the Property Law Act 1952 applied to allow deductions only for the expenses of sale before the proceeds are paid to the mortgagee.

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⁷ *Rob Mitchell Builder Limited (In Liquidation) v The National Bank of New Zealand Limited* (Court of Appeal CA 16/03, 26 November 2003, Blanchard, Tipping and Anderson JJ)

⁸ *CIR v Edgewater Motel* [2003] NZLR 425

In the courts

Ordinary resolution for sale of Fletcher Challenge Forests' forest estate

In December last year, the High Court ruled⁹ that Fletcher Challenge Forests Limited (FCF) only had to put an ordinary resolution to shareholders with a 50 per cent vote, rather than a special resolution with a 75 per cent vote, when forest assets owned by its subsidiaries are sold.

FCF has no interest in the forest assets owned by its subsidiaries, and is not a party to the sale agreements. However, the value of the forest assets is more than half of the value of FCF's assets (those assets largely being made up of shares in, and advances to, its subsidiaries).

There is no question that the sales will be "major transactions" in terms of section 129 of the Companies Act 1993 (the **Act**) for each of the selling subsidiaries.

The question for the court was whether the sales by the subsidiaries would also constitute a major transaction for FCF itself.

Section 129 governs transactions involving more than 50 per cent of a company's assets. However, the section refers only to "a company" and not to a company *and its subsidiaries*.

In a press release, FCF's board acknowledged the reasonableness of the view that a transaction of this nature could be regarded as a major transaction, which is why it sought declarations of the High Court.

In its application, FCF's lawyers noted that FCF's subsidiaries, and not FCF itself, are selling the forests. FCF is not itself disposing of any assets or incurring any obligations. As such, the transaction is not a major transaction for FCF, but only for the subsidiary companies actually selling the forests. The court agreed with this argument and confirmed that the test is applied on a company by company basis and does not "look through" to apply on a consolidated group basis.

In confirming that an ordinary resolution is all that is required, the judge noted that "*if a special resolution is to be required in circumstances such as those that exist in this case, then that should be specifically addressed by an amendment to the provisions of the section*".

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⁹ *Fletcher Challenge Forests Limited* (High Court, Auckland CIV 2003 404 5989, 5 December 2003, Salmon J)



In the journals

Enron accusations force banking rethink

A focus on the recent enforcement actions taken against Citigroup, JP Morgan and Merrill Lynch, who arranged structured finance transactions on behalf of Enron and were subsequently charged with assisting to manipulate earnings. The new procedures and mechanisms implemented by the banks in the aftermath of Enron's collapse provide useful guidelines for bankers and advisers to other companies that participate in, or arrange, structured finance transactions.

New Zealand's financial sector regulation

A summary of the New Zealand financial sector regulatory framework.

Banks get a grip on risk

A consideration of some of the major improvements to risk management practices that have been implemented in Australian banks in recent times.

The accidental insider trader: *Haylock v Southern Petroleum*

The decision in *Haylock v Southern Petroleum* (referred to in the Spring 2003 issue of *Financial Services Quarterly*) suggests that the interpretation of the Securities Markets Act 1988 by the Court of Appeal is unlikely to achieve the purpose of the legislation.

Anomalies and lacunae in the treatment of preferential creditors

Mike Gedye identifies what he considers are significant defects in the preferential creditor regime following implementation of the Personal Property Securities Act 1999. These defects could have adverse consequences for creditors.

Bank liability under constructive trusts: implications of the *Twinsectra* case

A recent House of Lords decision is good news for banks that assist in the transfer of trust property through bank accounts.

Swiss bank accounts – demolishing the myths

James Nason, Head of International Communications at the Swiss Bankers Association in Basel, answers questions frequently asked about Swiss bank accounts.

A brief history of Basel

A basic overview of what the Basel Accord is and how it came about, together with a summary of what Basel II is trying to achieve.

The mortgagee's duty on exercising the power of sale

A discussion of the Privy Council's consideration of a mortgagee's duty in New Zealand to take reasonable care to obtain the best price reasonably obtainable.

2002 ISDA Master Agreement: what constitutes good faith and reasonableness?

A consideration of how the terms "good faith" and "use commercially reasonable procedures in order to produce a commercially reasonable result", in the context of determining the Close-out Amount under the 2002 ISDA Master Agreement, could be interpreted under the laws of Australia.

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In the journals

Enron accusations force banking rethink

Chris Groobey, *International Financial Law Review*, November 2003

This article focuses on the recent enforcement actions taken against Citigroup, JP Morgan and Merrill Lynch, who arranged structured finance transactions on behalf of Enron and were subsequently charged with assisting to manipulate earnings. The new procedures and mechanisms implemented by the banks in the aftermath of Enron's collapse provide useful guidelines for bankers and advisers to other companies that participate in, or arrange, structured finance transactions.

The enforcement action defines new liabilities for banks involved in structured finance transactions and for the arrangers of such transactions. In each case, the banks settled the charges brought by federal and state regulatory authorities in the United States without admitting liability. Merrill Lynch paid a fine of US\$80 million, JP Morgan paid a fine of US\$135 million and Citigroup paid a fine of US\$120 million.

All three banks have since adopted new internal approval procedures for structured finance transactions and have submitted to increased oversight by regulators and independent auditors.

Banks lending into structured finance transactions and investment bankers and arrangers helping to structure such transactions cannot control the standard of financial reporting produced by their clients. However, they can reduce their exposure to a client's fraudulent activities by paying attention to the client's motivations for entering into a specific transaction and by refusing to participate in a transaction that they suspect could be used to mislead the investing public.

The author suggests that the charges brought provide a "roadmap" for bankers and advisers to follow and sets out a number of "red flags" to watch out for, summarised below.

The "Red Flags"

Bank should enforce disclosure by client	Arrangers should enforce their clients' obligations to disclose the full impact of a transaction.
Be wary if transaction increases operating income	Additional attention and scrutiny is necessary where the main objective of the transaction is to increase operating income, but where it appears that no true operations support the income.
Substance over form	Arrangers must consider whether the transaction is, in substance, a loan. If a participant in a structured finance transaction is entitled to an agreed return on their investment and is exposed to a credit risk that does not exceed that of a commercial lender, the transaction will be classified as a loan. Any attempt to treat it as operating income in the financial records of the client could result in an action against the bank as a counterparty.
Use of SPVs to disguise relationship between parties	Extra scrutiny is warranted where the fundamental reason for the creation of a special purpose entity is to enhance the distance between other participants in the transaction.
Timing of transaction will influence regulators	Regulators in the United States have indicated that they now will assume that all year-end transactions are undertaken for the purpose of meeting earnings expectations. Where the timing of a particular transaction coincides with the end of a reporting period, arrangers should exercise due caution to protect themselves from liability for their involvement in what might be a fraudulent transaction.
Courts will look through artificial separation of deals	Arrangers should be aware of the readiness of courts to group together transactions that, when viewed as a whole, result in reductions in risk to counterparts, return of sold assets or repayment of at-risk funds.

Emergency solutions may be a sign of fraud	Arrangers should be especially careful in dealings with clients who seek rapid balance sheet solutions where a failure to execute a transaction has created a shortfall in operating income.
Always get it in writing	Arrangers should be wary of oral or side agreements where the complete transaction is not contained in the governing documents.
Ethics will prevail	At the end of the day, arrangers must be confident that the transaction is ethical. Regulators in the United States have emphasised their desire to shift the focus of the review process from a strict reading of the applicable rules to an analysis of the ethical standard of the transaction.

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In the journals

New Zealand's financial sector regulation

Geof Mortlock, Financial Stability Department, *Reserve Bank of New Zealand Bulletin* Vol. 66 No. 4

This article sets out a summary of the New Zealand financial sector regulatory framework, and includes:

- a description of the core components of the financial system, including the financial institutions and financial markets; and
- an explanation of the infrastructure that supports the system.

The article also considers the main aspects of the regulatory framework of the financial system - in particular, banking supervision and securities market regulation.

The article is available online at www.rbnz.govt.nz under RBNZ Research.

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In the journals

Banks get a grip on risk

Bryan O'Connell, *Journal of Banking and Financial Services*, October/November 2003

This article considers some of the major improvements to risk management practices that have been implemented in Australian banks in recent times.

Substantial losses incurred in the 1980s, financial market volatility, political event risk through increased terrorism and increased regulation have all contributed to the constrained ways in which banks are focusing on increasing revenues and reducing costs.

This article gives specific examples of changes to risk management structures made by banks in Australia, and notes that they are using the Basel II Accord to raise the risk management bar even further.

It seems that the common aim, in addition to the obvious protection from an ever-increasing array of risks, is to enhance performance by better management of capital and risk management techniques.



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In the journals

The accidental insider trader: *Haylock v Southern Petroleum*

Susan Watson, *New Zealand Business Law Quarterly*, November 2003

This article considers the decision in Haylock v Southern Petroleum¹⁰ (referred to in the Spring 2003 issue of Financial Services Quarterly) and suggests that the interpretation of the Securities Markets Act 1988 by the Court of Appeal in that case is unlikely to achieve the purpose of the legislation.

What does the legislation provide?

The relevant provisions of the Securities Markets Act 1988 are summarised in the article as imposing liability on the insider's company for information:

- that is viewed as belonging to the company; and
- that the insider obtains about another listed company, independently of his or her position in the company to which the individual is an insider.

Why prohibit insider trading?

There are two rationales for the prohibition of trading in shares about which a person has "inside information":

- the information belongs to the company and should not be used to the insider's personal advantage (based on the common law principles of breach of confidence); and
- all participants in a publicly traded securities market should have access to the same information (based on market fairness).

Use of inside information is not necessary for liability to arise

The main issue considered by the court was whether the insider trading legislation in New Zealand gives rise to liability merely through being in possession of inside information, even when that information is not actually used for dealing or tipping. The court decided that it does, noting that if the intention was that liability would be imposed only if the person who "had" the information used or took advantage of it, then the legislation would have been worded that way.

It would therefore seem that the element of "moral fault" has no place in the legislation, despite the rationale of the Securities Markets Act being to enforce principles of equity and fairness, which, in the author's opinion, creates inappropriate outcomes.

However, the author noted that, as of August 2003, no successful actions against insider traders had been brought, suggesting that the legislation has not succeeded in its purpose of catching intentional wrongdoers. The government proposes to counter this by making insider trading a criminal offence with lengthy prison terms for offenders.

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¹⁰ (2003) 9 NZCLC 262,209; [2003] 2 NZLR 175

In the journals

Anomalies and lacunae in the treatment of preferential creditors

Michael Gedye, *New Zealand Business Law Quarterly*, November 2003

In this article, Mike Gedye identifies what he considers are significant defects in the preferential creditor regime following implementation of the Personal Property Securities Act 1999 (the PPSA). These defects could have adverse consequences for creditors.

While the amendments to the preferential creditor regime were not intended to change the existing law, the author considers that they have in fact done so, resulting in creditors being unable to adequately value collateral that includes inventory and accounts receivable.

The article contains arguments for amendments to the regime, including:

- Possibilities for certain assets to fall into more than one category of personal property, resulting in different treatment on insolvency - for example:
 - depending on circumstances, a bank account could be categorised as either an investment security, or an account receivable; and
 - depending on circumstances, a hire purchase agreement could be categorised as either chattel paper or as evidence of an account receivable.

Because the new regime requires secured creditors and insolvency administrators to pay preferential creditors from *accounts receivable* (and *inventory*) but not from other asset types, the categorisation of assets such as these becomes important to different classes of creditors.

- The potential for the definition of *inventory* to include goods held for lease, meaning that, because preferential creditors are payable in priority to general secured creditors from inventory that is not subject to a purchase money security interest, such assets may not be available to general secured creditors.
- The need for complex accounting for payments made to establish what assets are subject to purchase money security interests where some, but not all assets, have been purchased using a loan advance, or where some, but not all assets, purchased under retention of title terms have been paid for.
- Anomalies arising from difficulties in reconciling certain provisions of the Property Law Act 1952 with the PPSA.

The author suggests that the problems be addressed by abolishing the concept of preferential creditors and, in its place, to provide employees with the protection of a state insurance scheme. The author also notes that Crown preferences have been abolished in Australia and, more recently, in the United Kingdom and suggests they ought to be abolished in New Zealand as well.

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In the journals

Bank liability under constructive trust: implications of the *Twinsectra* case

Rhett Martin, *Australian Banking and Finance Law Bulletin*, (2003) 19(5) BLB 73

A recent House of Lords decision¹¹ has narrowed the test for third-party liability for breach of trust and is, therefore, good news for banks that assist in the transfer of trust property through bank accounts.

Where a bank has knowingly assisted in bringing about a transfer of trust property in breach of trust, it may be liable for assisting the breach of trust. In order to assist a breach of trust, the bank (or its employee) must act dishonestly.

Previously, the leading English case in this area¹² established an objective standard for dishonesty. However, the majority in this case introduced a new combined test of both subjective and objective standards. Under this new test, dishonesty arises where:

- the person's conduct was dishonest by the ordinary standards of reasonable and honest people; and
- they realised that, by those standards, their conduct was dishonest.

Constructive notice

The author considers that this case removes the risk that banks could be found liable for knowing assistance of breach of trust on the basis of constructive notice because, subject to the overriding caveat below, banks can now defend themselves against such claims if they were not actually aware that an action was dishonest.

Honest conduct

However, equally, a bank will not be able to escape a finding of dishonesty if it has offended generally accepted standards of honest conduct. A bank should always have regard to industry standards.

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¹¹ *Twinsectra Ltd v Yardley* [2002] 2 All ER 377

¹² *Royal Brunei Airlines v Tan* [1995] 2 AC 378

In the journals

Swiss bank accounts – demolishing the myths

James Nason, *Australian Banking and Finance Law Bulletin*, December 2003/January 2004

In this article, the Head of International Communications at the Swiss Bankers Association in Basel answers questions frequently asked about Swiss bank accounts.

James Nason notes that “*beloved by thriller and James Bond script writers, the so called ‘secret Swiss bank account’ – opened of course by shifty characters clutching attaché cases stuffed with cash – is perhaps the source of more myths, misunderstandings, clichés and sheer nonsense than any other aspect of contemporary retail banking*”.

This article separates fact from fiction by answering the following frequently asked questions:

- Who can open a Swiss bank account?
- How can an account be opened from another country?
- Is it possible to open an account via the internet?
- What questions will the bank ask?
- What documentation will the bank want to see?
- Is it possible to open an ‘anonymous’ account?
- What about ‘numbered’ accounts?
- Is there a minimum opening deposit?
- Does the account have to be in Swiss francs?
- How much interest will the bank pay on the investment?
- Can the Swiss Bankers Association recommend any particular bank?
- How ‘secret’ are Swiss banks?

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In the journals

A brief history of Basel

Benton Gup, *Journal of Banking and Financial Services*, October/November 2003

This extract gives a basic overview of what the Basel Accord is and how it came about. It also summarises what Basel II is trying to achieve.

The failure in the 1970s of the Hirstadt Bank in Germany, and the resulting disruption in international funds, was the trigger for 10 major trading countries to form the Basel Committee on Banking Supervision.

The Committee's original focus was to agree on best practices and thereby to harmonise international banking relationships. The stated objectives at that time were:

- to ensure an adequate level of capital; and
- to strive for competitive neutrality.

The accord has subsequently been adopted in more than 100 countries, including New Zealand.

Basel II is an attempt by international bank regulators to deal with the increasing complexity and risk sensitivity of the largest, most complex, financial organisations. It has three pillars:

- capital requirements;
- supervisory review; and
- market discipline.

The Reserve Bank of New Zealand website (www.rbnz.govt.nz) has more information on New Zealand's position with regard to the three pillars.

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In the journals

The mortgagee's duty on exercising the power of sale

Peter Devonshire, *New Zealand Business Law Quarterly*, November 2003

This article discusses the Privy Council's consideration of a mortgagee's duty in New Zealand to take reasonable care to obtain the best price reasonably obtainable, by reference to its decision in the Apple Fields case¹³ (summarised in the Winter 2003 issue of Financial Services Quarterly).

The Privy Council dismissed the mortgagor's appeal, affirming the New Zealand Court of Appeal's decision, concluding that there is no general rule that a company in which a mortgagee is interested cannot purchase the property at mortgagee sale.

The sale will be effective if the mortgagee complies with:

- its statutory obligation under section 103A of the Property Law Act 1952 to take reasonable care to obtain the best price reasonably obtainable; and
- its equitable duty to act in good faith.

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¹³ Apple Fields Limited v Damesh Holdings Limited [2001] 2 NZLR 586

In the journals

2002 ISDA Master Agreement: what constitutes good faith and reasonableness?

Megan O'Rourke, *Australian Banking and Finance Law Bulletin*, October 2003

This article considers how the terms "good faith" and "use commercially reasonable procedures in order to produce a commercially reasonable result", in the context of determining the Close-out Amount under the 2002 ISDA Master Agreement, could be interpreted under the laws of Australia.

The author concludes that both objective and subjective conduct is required in determining this amount – the objective requirement being that the relevant party must use commercially reasonable procedures and the subjective requirement being that the relevant party must act in good faith.

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Legislation/In Parliament

New Supreme Court for New Zealand

From 1 January 2004, appeals to the Privy Council have been abolished in favour of a new Supreme Court.

UPDATE: Securities Act non-compliance – the legislators step in

In October last year, Commerce Minister Lianne Dalziel appended a Supplementary Order Paper to the Business Law Reform Bill, which was due to be enacted by the end of 2003. Submissions on the Supplementary Order Paper closed on 19 November 2003. Enactment of the Bill is expected in March this year.

UPDATE: Reform of securities trading legislation

Targeted consultation was expected to be carried out towards the end of 2003, but consultation on the Securities Law Reform Bill now being drafted is expected to take place early this year, with the draft bill being presented to the House mid-way through this year.

UPDATE: Insolvency law reform – summary

The legislation reached a final round of decision-making in February last year, but is now not expected to be introduced until early this year.

UPDATE: Business law reform – what is it trying to achieve?

Submissions on the Supplementary Order Paper closed on 19 November 2003 and the Bill is now not expected to be enacted until March this year.

UPDATE: Consumer credit law reform

Proposed regulations under the legislation have now been issued.

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Legislation/In Parliament

New Supreme Court for New Zealand

From 1 January 2004, appeals to the Privy Council have been abolished in favour of a new Supreme Court.

The Supreme Court Act 2003 establishes the new Supreme Court of New Zealand and abolishes appeals to the Privy Council in England. The first judges of the Supreme Court are:

- Chief Justice Dame Sian Elias;
- Justice Andrew Tipping;
- Justice Thomas Gault;
- Justice Sir Kenneth Keith; and
- Justice Peter Blanchard.

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Legislation/In Parliament

UPDATE: Securities Act non-compliance – the legislators step in

In the Spring 2003 issue of Financial Services Quarterly, we reported on breaches of the Securities Act by certain Australian Registered Managed Investment Schemes.

Commerce Minister Lianne Dalziel has indicated that, notwithstanding speculation that the Government would retrospectively validate the breaches, it had not gone down that track. However, while automatic relief would not be provided, schemes would be able to seek relief from court.

Two of the affected parties have applied to the Wellington High Court to have allotments of securities retrospectively validated. If the application fails, they have indicated they will seek a judicial declaration as to which particular investors' units are affected.

In October last year, Ms Dalziel appended a Supplementary Order Paper to the Business Law Reform Bill in respect of the breaches, which was due to be enacted by the end of 2003. Submissions on the Supplementary Order Paper closed on 19 November 2003. Enactment of the Bill is now not expected until March this year.

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Legislation/In Parliament

UPDATE: Reform of securities trading legislation

In the Spring 2003 issue of Financial Services Quarterly, we reported on proposals announced by the Government to further strengthen New Zealand's securities trading legislation.

Targeted consultation was expected to be carried out towards the end of 2003, but consultation on the Securities Law Reform Bill now being drafted is expected to take place early this year, with the draft bill being presented to the House mid-way through this year.

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Legislation/In Parliament

UPDATE: Insolvency law reform – summary

In the Winter 2003 issue of Financial Services Quarterly, we summarised the Ministry of Economic Development's review of New Zealand's insolvency law.

The legislation reached a final round of decision-making in February last year, but is now not expected to be introduced until early this year.

We will update you on progress with the legislation in future issues of *Financial Services Quarterly*.

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Legislation/In Parliament

UPDATE: Business law reform – what is it trying to achieve?

In the Winter 2003 issue of Financial Services Quarterly, we summarised the aims of the Business Law Reform Bill, which includes important changes to the Companies Act and the PPSA.

Following a number of breaches of the Securities Act by certain Australian Registered Managed Investment Schemes, in October last year, Commerce Minister Lianne Dalziel appended a Supplementary Order Paper to the Bill. Submissions on the Supplementary Order Paper closed on 19 November 2003 and the Bill is expected to be enacted in March this year.

We will update you on progress with the legislation in future issues of *Financial Services Quarterly*.

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Legislation/In Parliament

UPDATE: Consumer credit law reform

In the Winter and Spring 2003 issues of Financial Services Quarterly, we provided an overview of the relevant provisions of the Credit Contracts and Consumer Finance Act 2003.

Proposed regulations under the legislation have now been issued and can be found on the Ministry of Consumer Affairs website at www.consumeraffairs.govt.nz, under Policy and Law.

The main parts of the new legislation do not take effect until April next year. In the next few issues of *Financial Services Quarterly*, we will guide you on what you should be doing, and by when, to ensure you're ready when the new legislation takes effect in April next year.

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Recent developments

Motor Vehicles Securities Register no longer available for searching

It is no longer possible to search the Motor Vehicles Securities Register. We recommend that you retain copies of any previous certificates of registration issued in relation to the Motor Vehicle Securities Register as proof of timing of any prior registrations.

New fast-track filing system for financial statements

The Companies Office has introduced an improved system for filing financial statements under the Financial Reporting Act 1993.

Proposed changes to stock exchange rules

The New Zealand Stock Exchange has sent the proposed NZX Participant Rules to the Minister of Commerce for review.

Link to PPSR security interests at Companies Office

It is now possible to access information about security interests registered against a specific company from a search of that company on the Companies Office website.

New Zealand accepted as signatory to the MOU of securities regulators

After a thorough screening process, New Zealand has been accepted as a signatory to the Multilateral Memorandum of Understanding Concerning Consultation and Co-operation and the Exchange of Information.

Australia adopts code of banking practice

A new industry-driven code of practice has been established for Australian banks.

UPDATE: Changes to International Accounting Standards

The International Accounting Standards Board has revised two International Accounting Standards that relate to financial instruments.

UPDATE: Directors and officers disclosure regulations approved

The Securities Markets (Disclosure of Relevant Interests by Directors and Officers) Regulations 2003 were promulgated in December last year and will come into force on 1 March.

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Recent developments

Motor Vehicles Securities Register no longer available for searching

*It is no longer possible to search the Motor Vehicles Securities Register (the **MVSR**).*

Given that all security interests in motor vehicles are registrable at the Personal Property Securities Register (the **PPSR**), and that all pre-existing security interests should have been re-registered there, the PPSR should be a complete record of all registered interests in motor vehicles.

However, if more than one security interest over a motor vehicle was re-registered during the transitional period, it may not be clear from the PPSR which secured party has better priority. For this reason, we recommend that you retain copies of any previous certificates of registration issued in relation to the MVSR as proof of timing of any prior registrations.

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Recent developments

New fast-track filing system for financial statements

The Companies Office has introduced an improved system for filing financial statements under the Financial Reporting Act 1993.

The aim is to make filing easier with a checklist that highlights the components of a complete set of financial statements. Once the documents have been submitted, registration is complete within 24 hours.

From February 2004, all company annual returns must be submitted in one of two formats:

- online at www.companies.govt.nz; or
- on the paper annual return form that is posted to company managers by the Registrar.

Historical approvals under section 214(8) of the Companies Act to vary the prescribed form of annual return will be revoked, and replacement paper annual return forms will be available from the Companies Office on request.

The Companies Office has reported that 87% of all annual returns are now filed online which incurs significantly lower fees, allows real time updates to company information and receives confirmation of filing.

The new form is available on the Companies Office website at www.companies.govt.nz.

For assistance with filing online, you can call the Companies Office on 0508 266 726.

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Recent developments

Proposed changes to stock exchange rules

The New Zealand Stock Exchange has sent the proposed NZX Participant Rules to the Minister of Commerce for review.

The NZX Participant Rules have been designed for the varied participants in New Zealand's capital markets. If accepted, they will replace the NZX Business Rules, NZX Regulations and Code of Practice.

The proposed rules address two areas of concern that were highlighted by market participants:

- they will allow bundling of orders within certain prescribed limits; and
- exclusion lists will be allowed on both the first and second offer of securities.

A full copy of the proposed NZX Participant Rules is available on the NZX website at www.nzx.com/regulation.

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Recent developments

[Link to PPSR security interests at Companies Office website](#)

It is now possible to access information about security interests registered against a specific company from a search of that company on the Companies Office website.

A new "Charges – PPSR" tab will appear at the top of the screen replacing the "Former Charges" tab. This function will be included as part of the company search fee.

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Recent developments

New Zealand accepted as signatory to the MOU of securities regulators

*After a thorough screening process, New Zealand has been accepted as a signatory to the Multilateral Memorandum of Understanding Concerning Consultation and Co-operation and the Exchange of Information (the **MOU**).*

New Zealand has now been verified as a country able to comply with the terms of the MOU. Being accepted as a signatory means that the New Zealand Securities Commission will be able to exchange essential information with regulators of other signatories when investigating breaches of securities law.

The MOU, developed by the International Organisation of Securities Commissions, provides an international system for cooperation by regulators to combat breaches of securities and derivatives laws, including fraud and market abuse.



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Recent developments

Australia adopts code of banking practice

A new industry-driven code of practice has been established for Australian banks.

On 1 August 2003, the Australian Bankers' Association released a new code of banking practice, which has been adopted by a number of Australian banks. The new code applies to small businesses as well as individuals and the provisions of the code form part of the contract between bankers and customers.

Perhaps the most interesting feature of the code relates to guarantees. The code states that not only should guarantors be provided with information about the guarantee but the bank should also provide the prospective guarantors with:

- financial accounts or statements of position of the borrower that are held by the bank;
- any notice of demand made by the bank on the borrower;
- information on whether the borrower has dishonoured any facilities with the bank; and
- notice of any over-drawings or excesses on any facilities the borrower has with the bank.

The code also states that all guarantees are to be limited. If participating banks do not comply with the guarantee provisions of the code they will not be able to enforce their guarantees.

For more information on the Australian code of banking practice, visit the Australian Bankers' Association website at www.bankers.asn.au.

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Recent developments

UPDATE: Changes to International Accounting Standards

In the Winter 2003 issue of Financial Services Quarterly, we foreshadowed the impending move to adoption of the International Financial Reporting Standards. The International Accounting Standards Board has revised two International Accounting Standards that relate to financial instruments.

The revised standards are:

- Standard 32, which sets out requirements for the presentation of financial instruments and identifies information that should be disclosed about them in order to assist others to assess the risk that an entity faces; and
- Standard 39, which specifies when and how financial assets and liabilities should be reported, requires derivatives to be accounted at fair value and restricts the use of hedge accounting. Further revision of this standard is expected in March to simplify some hedge accounting for banks and other financial institutions.

New Zealand versions of these International Accounting Standards will be released later this year by the Financial Reporting Standards Board (the **FRSB**).

The FRSB aims to have International Financial Reporting Standards available for use by New Zealand from 1 January 2005 and have mandatory application of the standards from 2007.

For more information, read the press release on the International Accounting Standards Board website at www.iasb.org.uk.

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Recent developments

UPDATE: Directors and officers disclosure regulations approved

In the Spring and Winter 2003 issues of Financial Services Quarterly, we reported on a discussion paper foreshadowing regulations to ensure that information about directors' and officers' shareholdings in listed companies is up to date and transparent.

The Securities Markets (Disclosure of Relevant Interests by Directors and Officers) Regulations 2003 were promulgated in December last year and will come into force on 1 March.

Announcing the regulations, Minister of Commerce, Hon. Lianne Dalziel stated that "*the purpose of the regulations is to improve transparency by ensuring that information about directors and officers holdings is up-to-date and relevant to the market ... and should reduce opportunities for insider trading and market manipulation*".



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Bell Gully news

Bell Gully is top New Zealand firm in Thomson M&A legal league tables 2003

UPDATE: New Zealand Court Of Appeal recognises "market reality" in overturning lower court decision in equity swaps case

New legislation set to address *Hammersmith* concerns

Wool Equities lists on NZAX

The Electronic Transactions Act - benefits for the bold or traps for the unwary?

Michael Cullen outlines the role of government

Bell Gully's submission to Securities Commission's consultation on corporate governance principles

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Bell Gully news

Bell Gully is top New Zealand firm in Thomson M&A legal league tables 2003

Bell Gully advised on the greatest value of completed M&A deals in 2003 of any New Zealand law firm, according to Thomson Financial's Australasian M&A legal league tables.

The firm ranked ninth for completed deals with any Australian or New Zealand involvement, the only New Zealand firm listed in this table.

Bell Gully's ranking was awarded for 12 completed transactions over US\$30 million, which together were worth US\$7.562 billion (NZ\$11.090 billion).

These results include Bell Gully's work on the second-largest deal in Australasia last year – advising ANZ Banking Group (New Zealand) Limited and its parent group on the acquisition of The National Bank of New Zealand Limited.

"Our people worked on a number of significant deals in New Zealand and Australia last year and this result reflects and rewards their hard work," said Brynn Gilbertson, who leads Bell Gully's Corporate/Commercial department.

"M&A transactions picked up significantly in the second half of 2003 and we expect that level of activity to continue into 2004."

Thomson Financial compiles details of all deals worth over US\$30 million and publishes these rankings twice each year. Further information is available at its website, www.thomson.com/league.

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Bell Gully news

UPDATE: New Zealand Court Of Appeal recognises "market reality" in overturning lower court decision in equity swaps case

As reported in the Winter 2003 edition of Financial Services Quarterly, in March 2003, the New Zealand High Court ordered the forfeiture of 12 million shares in Rubicon Limited owned by Perry Corporation.

In a unanimous decision handed down on 4 November 2003, the full bench of the New Zealand Court of Appeal overturned the decision of the High Court in *Ithaca (Custodians) Limited v Perry Corporation*.

The Court of Appeal's decision will be welcomed by participants in the equity swaps markets, who would have been unsettled with the ease at which the High Court inferred an "arrangement or understanding" giving rise to a disclosable "relevant interest" for the purposes of the Securities Markets Act 1988.

The Court of Appeal's judgment is littered with phrases that will be well received by the business world, such as "commercial reality", "practical business sense" and, in particular, "market reality". In fact, the latter phrase is the key to the Court's decision.

Bell Gully partner David Craig has prepared a newsletter (available at www.bellgully.com under Resources) outlining the broad basis for the decision principally as it affects the equity swaps market.

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Bell Gully news

New legislation set to address *Hammersmith* concerns

Ever since the House of Lords decision in Hammersmith was handed down in 1991, financial institutions have been wary of dealing with statutory corporations - particularly in relation to derivative transactions.

Likewise, lawyers giving enforceability opinions for these dealings have had to interpret some ambiguous, and often archaic, legislation and yet reach a "yes" or "no" conclusion.

A new Bill, introduced into Parliament in mid-December 2003, is designed to address these concerns for Crown entities. It contains sections designed to regulate the capacity of Crown entities to borrow, invest, guarantee and enter into derivative transactions.

Bell Gully partner David Craig has prepared a newsletter explaining the background to the Bill and its likely effects (available at www.bellgully.com under Resources).

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Bell Gully news

Wool Equities lists on NZAX

Wool Equities Limited listed successfully on the new NZAX Market on 20 November 2003.

Bell Gully advised both the New Zealand Wool Board on its disestablishment and restructuring, and Wool Equities Limited on its formation and subsequent listing on the NZAX market.

Bell Gully worked alongside investment bankers Cameron & Company and sponsor Forsyth Barr during this process.

Bell Gully has been involved in developing the NZAX Listing Rules and, with our expertise in capital raisings, main board listings and exchange compliance procedures, we are ideally placed to advise on all aspects of an NZAX listing.

We have prepared a number of articles on NZAX listings (available at www.bellgully.com under Resources).

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Bell Gully news

The Electronic Transactions Act - benefits for the bold or traps for the unwary?

With the Electronic Transactions Act now in force, senior associate Jeremy Salmond has analysed how this new legislation will affect business, especially information management and technological processes.

Jeremy's paper, first presented at the Information Management Summit 2003 held on 29 and 30 October 2003 in Wellington, is available at www.bellgully.com under Resources, Seminars.

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Bell Gully news

Michael Cullen outlines the role of government

Finance Minister Dr Michael Cullen outlined his views on the role of government during a speech at Bell Gully in November.

Speaking on the fiscal and legislative programme of the current Labour-Progressive Government, Dr Cullen commented upon four areas of government activity:

- a fiscal strategy characterised by transparency and a commitment to long-term stability;
- an active role in building and maintaining infrastructure;
- a pragmatic role as shareholder in key industries; and
- a role in redistributing resources within the community.

Dr Cullen's speech was part of last year's *Perspectives* series, talking points on contemporary issues presented by Bell Gully.

The full speech is available at www.bellgully.com under Resources, Seminars.

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Bell Gully news

Bell Gully's submission to Securities Commission's consultation on corporate governance principles

In the wake of Enron, corporate governance has been a hot topic throughout the corporate world - and New Zealand is no exception.

In September, the Securities Commission launched a national consultation process to establish consensus around a set of principles for corporate governance in New Zealand.

As part of this process, Bell Gully's corporate team prepared a detailed submission (available at www.bellgully.com under Resources) and letter for the Commission on the nine key issues identified for consultation:

- Ethical conduct
- Board composition and performance
- Board committees
- Reporting and disclosure
- Remuneration
- Risk management
- Auditors
- Shareholder relations
- Stakeholder interests

Submissions closed in November and the Commission is expected to report its findings to the Minister of Commerce by the end of February.

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Bell Gully news

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Corporate and Securities

Regulator Report

Technology

Communications, technology and media update
Spring 2003

Construction and Projects

Future-proofing infrastructure projects through risk management
November 2003

Employment

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December 2003

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The Independent, 26 November 2003

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in New Zealand
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Useful Web links

New Zealand Government

New Zealand Government [www.govt.nz]
NZ Government E-Commerce Information [www.ecommerce.govt.nz]
Office of the Clerk of the House of Representatives [www.clerk.parliament.govt.nz]
Parliamentary Counsel Office [www.pco.parliament.govt.nz]

New Zealand Government departments and organisations

The Companies Office [www.comcom.govt.nz]
Export Credit Office [www.treasury.govt.nz/exportcreditoffice]
Inland Revenue Department [www.ird.govt.nz]
Ministry of Economic Development [www.med.govt.nz]
Ministry of Foreign Affairs and Trade [www.mfat.govt.nz]
NZ Treasury [www.treasury.govt.nz]
NZ Law Commission [www.lawcom.govt.nz]
Office of the Banking Ombudsman [www.bankombudsman.org.nz]
Office of Insurance and Savings Ombudsman [www.iombudsman.org.nz]
Office of the Privacy Commissioner [www.privacy.org.nz]
Personal Property Securities Register [www.ppsr.govt.nz]
Reserve Bank of New Zealand [www.rbnz.govt.nz]
Securities Commission [www.sec-com.govt.nz]
Takeovers Panel [www.takeovers.govt.nz]

Australian Government

Banking Ombudsman [www.abio.org.au]
National Office for the Information Economy [www.ogo.gov.au]

New Zealand commercial sites

Institute of Chartered Accountants [www.icanz.co.nz]
NZ Business Roundtable [www.nzbr.org.nz]
NZ Institute of Economic Research [www.nzier.org.nz]
NZ Bankers' Association [www.nzba.org.nz]
NZ Stock Exchange [www.nzx.com]
CLANZ [www.clanz.org]

Australian commercial sites

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

International sites

Global Banking Law Database [www.gbld.org]
International Swap and Derivatives Association [www.isda.org]
International Monetary Fund [www.imf.org]
NAZDAQ [www.nasdaq.com]
New York Stock Exchange [www.nyse.com]
United States Securities and Exchange Commission [www.sec.gov]
World Bank [www.worldbank.org]
Bank for International Settlements [www.bis.org]

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