



**BELL GULLY**

# Commercial Quarterly

---

WINTER 2009

---



**Welcome to the Winter 2009 issue of *Commercial Quarterly*, Bell Gully's digest of current corporate and commercial law issues.**

Each quarter we preview upcoming developments and summarise recent cases and legislation of interest under the following headings:

**Commercial business law**  
**Company law**  
**Securities and capital markets**  
**Competition and consumer law**  
**Utilities and resources**

**In this issue, feature articles include:**

- Improving electricity market performance: preliminary Ministerial report;
- Simplified securities disclosure regime to apply from 1 October;
- Clear signals for future capital markets change – and more quick fixes now;
- Directors ordered to pay up;
- Recent developments affecting finance company activities;
- Changing regulatory functions at issue for New Zealand and Australian exchanges;
- Anti-Money Laundering and Countering Financing of Terrorism Bill;
- Commerce Commission's powers under scrutiny in Supreme Court;
- The correct way to fail;
- Section 92A – the latest instalment; and
- Contractual Remedies Act provides additional liability for assignees.

**Previous issues of *Commercial Quarterly* are available on our website.**

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

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

*Disclaimer: This publication is necessarily brief and general in nature. You should seek professional advice before taking any action in relation to the matters dealt with in this publication.*

## Commercial business law

### **Contractual Remedies Act provides additional liability for assignees**

A recent Court of Appeal case has confirmed that the Contractual Remedies Act 1979 alters the common law position applicable to contractual assignments by finding that a contract and its benefit together with its burden may now be assigned. This opens the way for the non-assigning party to bring an independent cause of action against the assignee for a breach of the assignor's obligations.

### **RMA bill – still room for improvement**

The Local Government and Environment Committee reported back on the Resource Management (Simplifying and Streamlining) Amendment Bill in August 2009. The select committee has redressed a number of the concerns identified by Bell Gully in the first draft of the bill. However, as outlined by senior partner David McGregor, partner Andrew Beatson and senior solicitor Vivienne Holm in this update, Bell Gully still has serious concerns with several of the proposals.

### **Anti-Money Laundering and Countering Financing of Terrorism Bill**

Bell Gully has prepared a practical guide to assist you to understand the Anti-Money Laundering and Countering Financing of Terrorism Bill introduced to Parliament in June.

### **Major changes proposed to search and surveillance powers**

Parliament is currently considering a law change that could mean increased powers of search and surveillance for a number of regulatory agencies, including the Commerce Commission, local authorities and the Overseas Investment Office. In this article, senior associate Peter Jenkins and solicitor Jesse Wilson outline the background to and key features of the new Search and Surveillance Bill 2009.

### **Defrauding creditors by transferring assets to trusts**

The Supreme Court has provided further guidance on when it will rule that the transfer of assets to a trust constitutes intent to defraud creditors.

## Commercial business law

### **Contractual Remedies Act provides additional liability for assignees**

*A recent Court of Appeal case has confirmed that the Contractual Remedies Act 1979 alters the common law position applicable to contractual assignments by finding that a contract and its benefit together with its burden may now be assigned. This opens the way for the non-assigning party to bring an independent cause of action against the assignee for a breach of the assignor's obligations.*

#### **The facts**

The case<sup>1</sup> concerned an assignment by a building contractor, JR Construction Limited (**JRC**) of "all its rights, title and interest" in a contract to perform site works for SB Properties Limited (the non-assigning party) to an assignee, Mr Holdgate. In effect, this gave Mr Holdgate the right to call for progress payments to be paid to him personally upon completion of the work by JRC. However, at the time the contract was assigned, SB Properties had terminated the contract for non-completion of the work by JRC and there was only a small non-contested sum owed to JRC under the contract.

Having terminated the contract prior to completion of the site works, SB Properties engaged a substitute contractor to complete the contracted work and brought claims against JRC (then in liquidation) and Mr Holdgate, on discovering that the contract had been assigned to him, for damages (based on the difference in the actual cost of the works paid by SB Properties and the JRC contract price).

#### **Background to the legal issues**

In contract law, an assignment involves one party transferring some or all of its rights to a third party (the assignee), so that the assignee is entitled to the contractual benefits from the non-assigning party. An assignment in itself however does not create a contract between the assignee and the non-assigning party, nor does it make the assignee a party to the original contract. Further, an assignor can not relieve itself of its contractual obligations by assigning the burden of a contract without the consent of the non-assigning party. Under the common law, this means the non-assigning party has no right to bring an action for damages against an assignee for breach of a contractual obligation by an assignor.

In contrast, section 11(1) of the Contractual Remedies Act 1979 states that "if a contract...is assigned, the remedies of damages and cancellation shall...be enforceable by or against the assignee".

The question before the Court of Appeal was therefore whether section 11(1) of the Contractual Remedies Act had altered the common law position governing assignments, with the effect that in addition to the continuing liability of JRC, SB Properties had an independent cause of action against Mr Holdgate as the assignee.

#### **The decision**

The court held that in light of the "emphatic language" of section 11(1) a contract and its benefit together with its burden may now be assigned. Section 11(1) had improved SB Properties' position by granting an independent cause of action against Mr Holdgate for the breach of JRC's contractual obligations. This represents a change from the common law position. However, the court found that in all other respects the common law applicable to assignments remains unaltered. In particular, the court confirmed that JRC as the assignor remained liable to SB Properties.

There is also an important qualification to an assignee's liability under the Contractual Remedies Act. Under section 11(2) of the Act "the assignee shall not be liable in damages...in a sum exceeding the value of the performance of the assigned contract to which he is entitled by virtue of the assignment". The court held that this meant Mr Holdgate as the assignee was not liable to SB Properties for any amount beyond "the amount by which the assignee was enriched by the non-assigning party's performance of the contract [i.e.

---

<sup>1</sup> *SB Properties Limited (in liquidation) v Holdgate (CA) CA453/2008 [24 July 2009]*

the net increase in the assignee's assets following the assignment]". In order to claim any surplus to the amount claimed from the assignee, the non-assigning party must look to the assignor.

On the facts, Mr Holdgate did not derive any value from the assignment. All payments during the course of the contract were paid to JRC. As a result this meant no damages were payable by Mr Holdgate.

### **Comment**

Prior to the enactment of the Contractual Remedies Act, a party to a contract had no right to bring an action for damages against an assignee for breach of an obligation by an assignor. This case confirms that the Act has altered the common law position in this respect, subject to the assignee being liable for no more than the net increase in the assignee's assets following the assignment.

However, it is important to note that the Contractual Remedies Act does not alter the law on assignment of contractual liabilities with regards to an assignor. A contracting party is not relieved of its contractual obligations by assigning the burden of the contract; that can only be achieved with the consent of the assignee and the original contracting parties by novation, where the non-assigning party consents to the release of the assignor and the substitution of the assignor by the assignee.

## Commercial business law

### RMA bill – still room for improvement

*The Local Government and Environment Committee reported back on the Resource Management (Simplifying and Streamlining) Amendment Bill in August 2009. The select committee has redressed a number of the concerns identified by Bell Gully in the first draft of the bill (refer to ["Bell Gully's take on changes to the RMA"](#) in the Autumn 2009 issue of Commercial Quarterly). However, as outlined by senior partner David McGregor, partner Andrew Beatson and senior solicitor Vivienne Holm in this update, Bell Gully still has serious concerns with several of the proposals.*

The key changes made to the Resource Management (Simplifying and Streamlining) Amendment Bill by the select committee and our comments on those changes are:

#### **Scope of appeals**

The select committee has removed the provisions limiting appeals on proposed plans and plan changes to points of law. As we noted in our earlier newsletter, this proposal had the potential to heighten concerns that local authorities often act as "the judge in their own cause" in this context.

#### **Trade competitors**

The bill still goes too far in terms of the provisions restricting the rights of trade competitors, by curtailing landowners' rights to seek appropriate provision for their own properties in district and regional plans. A person who could gain an advantage in trade competition through a submission on a plan may only proceed if, "directly affected by an effect of the proposed policy statement or plan" that, "adversely affects the environment". As such, landowners can no longer make submissions seeking a zoning for their own properties to help facilitate any activity which is subject to trade competition.

We consider that this restriction is inappropriate.

#### **Incentivising faster decision-making**

The first draft of the bill introduced a new requirement that local authorities adopt a policy for discounting administrative charges where a resource consent is not processed within the statutory timeframe and it is at fault. Bell Gully raised concerns that the bill did not provide sufficient clarity on the extent of any discounts, or ensure that the amount of the discount would continue to increase as time went on after the trigger date has passed (to encourage ongoing efforts to resolve the application as quickly as possible).

The select committee has amended the bill to require the Minister to make regulations setting out model discounts. These must be followed by all local authorities, unless they choose to implement a policy which is "more generous than that provided for in the regulations".

We would expect that the regulations will be designed in a way which meets our concerns.

#### **Public notification**

The first draft of the bill specified that public notification would only be required if the consent authority was satisfied that the adverse effects of the activity beyond the immediate environment, "will" be more than minor. That wording imposed a high threshold of certainty and has been replaced with the word "may".

The select committee has also adopted Bell Gully's suggestion that the reference to effects beyond the "immediate environment", which we considered to be vague and uncertain, be replaced with the words "adjacent land".

The new provisions specify that when the consent authority is deciding whether adverse effects may be more than minor, it must disregard any effects "on persons who own or occupy" the land involved and on, "any land adjacent to that land" (whose owners and occupiers are likely to be treated as affected persons, unless the effects on them are considered to be less than minor or they have provided a written approval).

## **Representation at proceedings**

The final matter raised in our earlier newsletter related to provisions in the bill which provided that only the Attorney-General could represent the public interest in proceedings in the Environment Court. We noted that other parties, including statutory or iwi authorities and industry representatives, would often be better placed in terms of institutional knowledge, inclination and resources to do so.

This concern remains unresolved, although we note that it may be possible for these groups to be involved if they made a submission about the subject matter of proceedings.

## **Non-complying and Restricted Discretionary Activities**

The select committee rejected the proposal to abolish non-complying activities.

It is also proceeding with changes to the consenting regime for restricted discretionary activities, with the bill reversing a recent High Court case which had stated that while a consent authority's discretion to refuse consent was limited to any specified matters, it was entitled to grant consent on the basis of other considerations.

## **Infrastructure**

The select committee has removed the provision in the first draft of the Bill which enabled territorial authorities to require (rather than request) changes to outline plans.

As requested by Bell Gully, it has also amended the Minister's call in powers on proposals of national significance to include those that cross district council boundaries (and not only those that cross regional boundaries). This will assist infrastructure providers such as ARTA to access new consenting pathways (although further amendments might be required once the Auckland Council is established and the region no longer has any districts).

The select committee noted that "any changes to the designation process would benefit from further analysis in the wider context of a review of the way the RMA manages infrastructure as a whole".

We understand that infrastructure is one of the work streams which is being prioritised by the Ministry and that a bill can be expected early next year.

Key initiatives identified to date include:

- a review of the role of designations and facilitating infrastructure development and an examination of options for reviewing and streamlining the designation mechanism;
- an investigation of alternatives to designations planning for and managing the effects of activities on network infrastructure;
- an investigation of whether compensation under the Public Works Act 1981 needs to be shorter but more generous to landowners; and
- streamlining and integrating processes under the Public Works Act and other legislation.

## **Second phase of reform**

In addition to infrastructure the Government has identified nine further related work streams on future RMA reform:

- addressing barriers to sustainable and cost-effective aquaculture development;
- alignment of consenting processes under the RMA and the Building Act 2004 (to create a "one stop shop" system or simpler proposals);
- alignment of consenting process under the RMA and the Conservation Act 1987;
- developing further the scope, functions and structure of the EPA;

- alignment of consenting processes under the RMA and Forests Act 1949 and Forests Amendment Act 1993;
- investigating generic issues in the RMA that were too complex to be dealt with in phase 1;
- alignment of consenting processes under the RMA and Historic Places Act 1993;
- exploring better approaches to urban planning; and
- establishing a fairer and more efficient water management system.

These investigations present an opportunity for those experiencing difficulties with the Act to take the initiative and pursue any other amendments which have not yet been identified. Bell Gully is pursuing such amendments on behalf of several clients and is happy to advise on these matters.

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

**Auckland**

[David McGregor](#)

Senior Partner

[Josh McBride](#)

Senior Associate

[Vivienne Holm](#)

Senior Solicitor

**Wellington**

[Andrew Beatson](#)

Partner

[Carolyn Hintz](#)

Senior Solicitor

*This article was first published on 19 August 2009*

## Commercial business law

### **Anti-Money Laundering and Countering Financing of Terrorism Bill**

*Bell Gully has prepared a practical guide to assist you to understand the Anti-Money Laundering and Countering Financing of Terrorism Bill introduced to Parliament in June.*

A draft law aimed at eradicating money laundering and terrorist financing is now before Parliament.

The Anti-Money Laundering and Countering Financing of Terrorism Bill was introduced to Parliament in June 2009, after an extended period of consultation.

This new legislation upgrades the Financial Transactions Reporting Act 1996 and will have significant implications for many businesses in New Zealand. Importantly for Australasian businesses, the bill has substantial alignment with the Australian Anti-Money Laundering and Counter-Terrorism Financing Act 2006. However, there are also a number of areas of divergence between the two countries.

Bell Gully has prepared a [practical guide](#) to assist you to understand the bill and to help with compliance planning.

Submissions on the bill closed with the Foreign Affairs, Defence and Trade Select Committee on 6 August 2009. The legislation is expected to be passed into law in the third quarter of 2009. There will then be a two year transitional period before the new regime comes into effect.

[Click here for further details of the bill's progression.](#)

#### **For further information contact:**

[Mark Todd](#)

Partner

[David Craig](#)

Partner

[Murray King](#)

Partner

[Jonathan Ross](#)

Partner

[Haydn Wong](#)

Partner

## Commercial business law

### Major changes proposed to search and surveillance powers

*Parliament is currently considering a law change that could mean increased powers of search and surveillance for a number of regulatory agencies, including the Commerce Commission, local authorities and the Overseas Investment Office. In this article, senior associate Peter Jenkins and solicitor Jesse Wilson outline the background to and key features of the new Search and Surveillance Bill 2009.*

The Search and Surveillance Bill 2009 aims to update the law relating to use of search powers, particularly by the police. The measures would also apply to a number of regulatory agencies, including the Commerce Commission, local authorities and the Overseas Investment Office.

Much of the bill simply seeks to update the rules on search powers by codifying what has become common practice or by taking into account recent developments in information technology. Many of the bill's proposals are based on the recommendations made in the Law Commission's Report, Search and Surveillance Powers (June 2007), and are intended to, among other things:

- improve the consistency and coherence of the search powers granted to regulatory agencies;
- reduce the uncertainty as to the nature and extent of certain existing search powers granted to regulatory agencies;
- increase the powers of regulatory agencies to deal with unlawful activity committed through or facilitated by electronic devices; and
- address concerns about the quality of applications for search warrants.

However, the powers of the Commerce Commission in applying for and executing search warrants will be expanded as they are brought into line with the new regime. One aspect of the bill that may prove controversial is the proposal to extend the power to obtain surveillance warrants to agencies such as the Commerce Commission.

Currently, the Commerce Commission's rights and powers in relation to search warrants are set out in the Commerce Act 1986 and the Fair Trading Act 1986. Proposed changes from the current regime include:

- The power conferred by a search warrant will include the power to detain any persons at the search scene in order to determine if they are connected with the search.
- The power to remove or copy any material will expressly include the power to copy any intangible material from a computer or other information storage device.
- An officer of the Commission will be allowed to seize as evidence any material that they find while lawfully on a premises, even if not executing a search warrant or there for an unrelated purpose.
- A search warrant will be able to be issued in respect of legally privileged material if the issuer is satisfied that the purpose of the communication was to plan or commit an offence or otherwise dishonest. Special provisions will apply to the issue of search warrants over a lawyer's premises.
- The Commission will be given a new power to apply for a surveillance warrant authorising the use of surveillance devices, including interception devices, tracking devices or visual surveillance devices.
- The issue of a surveillance warrant will allow enforcement officers to enter specified premises to install a surveillance device.
- The Commission will be able to apply for a "residual warrant" authorising an investigative technique that is not otherwise covered by the bill.

Given their significance, the proposed changes require close scrutiny. The Law Commission itself has acknowledged that the proposed surveillance warrant measures are "novel" and the extension of these

powers to non-police agencies may raise concerns "about the potential creep of state powers and the emergence of a surveillance society".

As the experiences in other jurisdictions demonstrate, when regulatory agencies are given additional powers, the powers can be used in ways that are not always consistent with the purposes for which they were intended. Those who deal with the regulators will be concerned to ensure that they will only be able to use any new search powers in a responsible and proportionate manner.

The bill is now before the Justice and Electoral Select Committee and the public has been invited to make submissions.

Some of the issues that ought to be addressed during the process include:

- the justifications for, and proportionality of, some of the expansions of the search and surveillance powers of the regulatory agencies;
- whether it is necessary for commercial regulators such as the Commerce Commission to obtain police-style surveillance powers given that they already enjoy many powers that the police do not (such as information-gathering notices and the ability to compel individuals to answer questions); and
- more generally, whether the powers of various regulatory agencies to obtain search and surveillance warrants should be consolidated under a single statute as proposed or whether the public interest is better served by differentiated powers under specific statutes.

Submissions on the bill close on 18 September 2009 and the committee is due to report back on the bill on 4 February 2010. We will continue to monitor the bill's progress through Parliament and report on future developments.

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

#### **Auckland**

[Ralph Simpson](#)

Partner

[David Cooper](#)

Partner

[Jenny Cooper](#)

Partner

[Ian Gault](#)

Partner

[Simon Ladd](#)

Partner

[Roger Partridge](#)

Partner

[Peter Jenkins](#)

Senior Associate

[Jesse Wilson](#)

Solicitor

#### **Wellington**

[Mike Colson](#)

Partner

[Mark O'Brien](#)

Partner

[David Blacktop](#)

Senior Associate

[Jenny Stevens](#)

Senior Associate

## Commercial business law

### Defrauding creditors by transferring assets to trusts

*The Supreme Court has provided further guidance on when it will rule that the transfer of assets to a trust constitutes intent to defraud creditors.*

In *Regal Castings v Lightbody* the Supreme Court considered a transfer of property by a debtor to his family trust which was said to have been made with intent to defraud creditors. The court found that the transfer of property was void.

#### **The facts of the case**

Regal Castings loaned Mr Lightbody a substantial sum to provide capital for his business. Without telling Regal Castings, Mr Lightbody transferred his house, which was his only substantial asset, to a family trust. When Mr Lightbody subsequently defaulted on the loan, Regal Castings obtained judgment against him. The creditor then brought the present claim under section 60 of the Property Law Act 1952 (**PLA 1952**) to set aside the transfer of the property as having been made with an intent to defraud.

It was suggested during the hearing that a transfer of property for no consideration gave rise to a presumption of an intention to defraud. The majority of court found it unnecessary to decide whether this was correct. They instead held that the question of intent remains one of fact, but accepted that an inference of fraudulent intent may be drawn from the facts.

Counsel for Regal Casting argued that Mr Lightbody's financial circumstances were precarious, and the position of Regal Casting was inevitably prejudiced by transferring Mr Lightbody's only substantial asset. In those circumstances an intention to defraud was established.

The court agreed that the circumstances showed an intention by Mr Lightbody to defraud his creditors. In reaching this conclusion, in our view the Court has lowered the bar for the conduct sufficient to trigger section 60 of the PLA 1952. Mr Lightbody knew that one of the effects of the trust arrangement was to protect assets, but there was nothing untoward in the terms of the trust deed. The house had been transferred at value, and the gifting programme was normal. To find Mr Lightbody had an intent to defraud the creditor ultimately required the court to infer a level of calculation and sophistication on the part of Mr Lightbody that arguably did not exist.

#### **The effect of the decision**

Since 1 January 2008, it is no longer necessary to prove that the debtor disposed of the relevant property with intent to defraud creditors. A transaction may be set aside if the relevant property was disposed of:

- as a gift; or
- without receiving reasonably equivalent value in exchange.

The case of *Regal Castings* is, however, still relevant because section 346 of the PLA 2007 provides that a disposition of property may be void if it is done with intent to defraud creditors. Also, transfers of property to trusts prior to 1 January 2008 are still governed by section 60 of the PLA 1952 and the decision in this case.

#### **For more information, please contact:**

[Daniel Vizor](#)

Senior Associate

## Company law

### **Directors ordered to pay up**

In the continuing saga of the Mason v Lewis litigation, the Court of Appeal has provided some relief for the two directors' overall liability to the company, but in all other respects its most recent decision echoes the High Court's earlier message: "delinquent directors beware".

## Directors ordered to pay up

*In the continuing saga of the Mason v Lewis litigation, the Court of Appeal has provided some relief for the two directors' overall liability to the company, but in all other respects its most recent decision echoes the High Court's earlier message: "delinquent directors beware".*

### Background

This is the second time this litigation has been before the Court of Appeal. In the [Autumn 2006 issue of Commercial Quarterly](#) we discussed the Court of Appeal's decision in *Mason v Lewis*<sup>2</sup> in which Mr and Mrs Lewis, in their capacity as directors of Global Print Strategies Limited (in liquidation) (Global), were held to have breached their statutory duties under section 135 of the Companies Act 1993 for reckless trading and sections 194 and 300 of the Act for failing to keep financial records. However, at the time, the Court of Appeal was unable to make contribution and compensation orders for the Lewises' breaches because the High Court had not considered all of the issues relating to quantum at the initial hearing. This part of the liquidator's claim was remitted back to the High Court for it to determine what quantum orders were appropriate. A case note on the High Court's decision<sup>3</sup> was included in the [Spring 2008 issue of Commercial Quarterly](#).

This recent Court of Appeal decision<sup>4</sup> was the outcome of an appeal by the Lewises from the High Court judgment in which orders were made under sections 300(1) and 301 of the Companies Act 1993 that they both pay substantial amounts (being over twice the amount of the Court of Appeal's cap) for breaches of their duties as directors.

The principal issue was whether the High Court had erred in not following the Court of Appeal's stipulation that the liability of the Lewises was not to exceed \$560,000. The High Court had seen this stipulation as something which it was not bound by on the basis that the amount did not form part of the Court of Appeal's reasoning in its finding of liability against the Lewises.

### The Court of Appeal's decision

The Court of Appeal agreed with the Lewises that the High Court had been wrong to exceed the sum stipulated by it. The \$560,000 figure was the amount that had been claimed by the liquidators at the first hearing of the Court of Appeal and the court had made it a condition on which the matter had been remitted back to the High Court (rather than a step in the court's reasoning).

The Lewises however were not content with this finding and asked that the Court of Appeal to proceed with the appeal on the basis that they could establish that the appropriate quantum of liability was less than \$560,000.

In determining the total amount of the Lewises' liability, the High Court had followed the "standard approach" under sections 300 and 301 which had been referred to by the Court of Appeal in its previous decision. The approach begins by looking at the deterioration in the company's financial position between the date inadequate corporate governance became evident and the date of liquidation. Once that figure has been ascertained, there are three factors which are relevant to the exercise of the court's discretion:

- causation (in so far as there is a clear link between the Lewises allowing the company to continue to trade beyond August 2000 and the indebtedness to creditors that subsequently arose);
- the duration of the trading; and
- the extent of the Lewises' culpability.

This appeal required the Court of Appeal to consider whether the High Court judge had been in error in various assessments he had made under the "standard approach", including his assessment of:

---

<sup>2</sup> [2006] 3 NZLR 225

<sup>3</sup> *Mason v. Lewis & Anor* (Unreported Judgment, Stevens J, H.C., Auckland, CIV 2003-404-0936; 1 October 2008)

<sup>4</sup> *Lewis & Anor v Mason* [2009] NZCA 306

- the creditor pool;
- the causation; and
- the culpability of the Lewises.

The Court of Appeal rejected all of the Lewises' arguments on these issues and ordered Mr and Mrs Lewis to contribute the sum of \$560,000 to the assets of Global by way of compensation for their breach of duty to Global under section 135.

In reaching this decision, the court:

- agreed that the High Court had been correct to include post-liquidation interest in calculating the creditor pool, noting that the fact that the interest payment obligation will continue post-liquidation will be obvious to directors, and will be a relevant factor in deciding whether continued trading is consistent with the section 135 duty;
- Disagreed with the argument that Global's losses would have resulted whether or not the Lewises had complied with their directors' duties, since they were the minority shareholders and did not actively participate in the management of the day-to-day operations of the company. The court found this argument untenable as it was equivalent to saying that directors could "wash their hands of their duties except where they held a majority of the shares." As to what action was expected of directors in a similar situation to the Lewises, the court notes:

*"They could have obtained advice about how to manage the dire financial position into which the company had fallen. They could have resolved that the company would stop trading. They could have taken steps to ensure further debts were not incurred in circumstances where the company was not able to pay them. The reality is they took no meaningful action at all. They cannot throw their hands in the air and say it was not their fault."*

- Agreed with the High Court's assessment that there was no reason to find Mrs Lewis any less culpable than her husband, despite only having become a director at the instigation of her husband and having had less involvement with the company than her husband.

The Lewises had also argued that the compensation should have been reduced because of the contributory conduct of the main secured creditor of Global which was set to benefit from the proceedings. The court made no finding on this point as it agreed with the High Court's conclusion that the involvement of the creditor in question did not have the effect of increasing the overall indebtedness of Global, albeit it had the effect of converting what would otherwise have been unsecured debts into a secured debt. The court, however, did acknowledge that there was a case for taking into account the contributory conduct by a creditor where that creditor will be the only beneficiary of an award and any reduction in the amount that would otherwise be awarded has no effect on other creditors. Conduct of a creditor may also be relevant where the s 301 proceedings are instigated by a creditor seeking an order under s 301(1)(c) that money be paid to the creditor.

### **Comment**

The Lewises may have achieved a partial victory in this case thanks to inadequate pleadings by the liquidators in the initial Court of Appeal hearing, but the case stands as an example of the significant personal liabilities directors may face if they fail to meet the standards required of their office.

In the High Court decision Justice Stevens noted that this case was a timely reminder of a fundamental principle of the Companies Act 1993 that company directors must take proper steps to place themselves in a position to guide and monitor the management of the company and noted that:

*"The responsibility for the governance of the company is theirs. They cannot simply treat the appointment as a sinecure and then leave to management, or other advisers, the duties of running the company and ensuring compliance with legal obligations. Let delinquent directors beware."*

This message still holds true.

## Securities and capital markets

### **Securities law changes passed**

New securities laws with measures to streamline raising capital for New Zealand businesses are now in effect.

### **Simplified securities disclosure regime to apply from 1 October**

Commerce Minister Simon Power announced on 26 August that Cabinet had approved new securities regulations (the Securities Regulations 2009) which implement a range of recommendations made by the Capital Market Development Taskforce, including the implementation of the simplified disclosure prospectus regime. In this article, senior associate Stephen Layburn provides a brief overview of the new regulations.

### **Clear signals for future capital markets change – and more quick fixes now**

The Capital Market Development Taskforce, appointed by the Government last July, has released a progress report identifying major issues facing New Zealand's capital markets. It builds on its earlier interim report, released last December, adding to the list of quick fixes identified in the interim report and setting the scene for the likely recommendations to be contained in its final reports now due this December. In this article, senior associate Stephen Layburn outlines the taskforce's latest recommendations.

### **Changing regulatory functions at issue for New Zealand and Australian exchanges**

In this article, senior associate Stephen Layburn discusses NZX's proposals to reallocate some of its capital markets regulatory functions as set out in a discussion document prepared for the Capital Market Development Taskforce.

### **Recent developments affecting finance company activities**

In this update, senior associate Stephen Layburn discusses four recent developments which impact on the finance company sector, namely: the extension of the retail deposit guarantee scheme; a proposed new licensing regime for corporate trustees who supervise debt issuers (including finance companies); the introduction of regulations which will simplify and clarify disclosure obligations for finance company moratorium proposals by the end of the year; and the Commerce Select Committee's inquiry into finance company failures.

### **Takeovers Panel considers class exemption for rule 16(b)**

In August, the Takeovers Panel released a consultation paper on whether to grant a class exemption from rule 16(b) of the Takeovers Code. The paper discusses the Panel's current approach in granting specific exemptions from rule 16(b), the appropriateness of granting a class exemption and the possible terms and conditions of a class exemption.

### **NZX rule consultation for new clearing and settlement systems**

Over the last 18 months, NZX has been working on implementing new clearing and settlement systems and infrastructure for its core trading markets and it has now released five Consultation Memoranda on various changes which are required for the implementation of the new system. In addition, NZX is also taking the opportunity to bring NZX's corporate action entitlement processing in line with international best practice.

## Securities and capital markets

### Securities law changes passed

*New securities laws with measures to streamline raising capital for New Zealand businesses are now in effect.*

The Securities (Disclosure) Amendment Act 2009, which amends the Securities Act 1978, and the Financial Advisers Amendment Act 2009, which makes some minor changes to the Financial Advisers Act 2008, came into force on 28 July.

The changes were first introduced into Parliament in February as one bill (the Securities Disclosure Amendment and Financial Advisers Amendment Bill) and flowed from the first round of recommendations of the Capital Market Development (CMD) Taskforce for steps to respond to financial conditions. (See our article in the Summer 2009 Commercial Quarterly, "[Responding to the financial crisis: the Securities Disclosure and Financial Advisers Amendment Bill](#)", for further details.)

One of the core provisions of the bill introduced a simplified disclosure prospectus (SDP) regime into the Securities Act. In addition, the bill contained changes to the exceptions (safe harbours) in sections 3(2) of the Securities Act and to the "eligible persons" regime making it easier for all companies - both listed and unlisted - to raise capital.

As the bill progressed through Parliament it underwent a number of changes (see our commentary in the [Autumn 2009 issue of Commercial Quarterly](#)) and was later divided into two bills. In addition to the select committee changes noted in our previous newsletter, a number of minor amendments were made by supplementary order papers. These included:

- aligning section 5(2CB)(a) of the Securities Act 1978 with new section 5(2CBA) of the same Act by clarifying that offers of securities that are made to "eligible persons" can also be made to persons outside New Zealand at the same time; and
- providing that new section 5(2CBA) of the Securities Act will permit offers of securities that are made to "eligible persons" and persons who fall within one or more of the categories set out in section 3(2)(a)(i) to (iii) of the Securities Act to be made also to persons outside New Zealand at the same time ( see section 7 of that Act).

Minor clarifications have also been made over the additional powers added to the Securities Act enabling the Securities Commission to make certain orders in relation to a SDP which is deficient or defective (including by delaying or prohibiting allotment). One further amendment corrects two typographical errors in the Financial Advisers Act 2008.

The SDP regime will become operative when the Securities Regulations 2009 come into force on 1 October 2009. These regulations include provisions which outline the scope of the SDP regime and set out the details of the information to be provided in a SDP. For further discussion of these regulations see the article "[Simplified securities disclosure regime to apply from 1 October](#)" in this issue of Commercial Quarterly.

## Securities and capital markets

### **Simplified securities disclosure regime to apply from 1 October**

*Commerce Minister Simon Power announced on 26 August that Cabinet had approved new securities regulations (the Securities Regulations 2009) which implement a range of recommendations made by the Capital Market Development Taskforce, including the implementation of the simplified disclosure prospectus regime. In this article, senior associate Stephen Layburn provides a brief overview of the new regulations.*

The Securities Regulations 2009, which are a complete replacement of the Securities Regulations 1983, will come into force on 1 October 2009. However, under transitional provisions issuers will be able to elect to offer securities under the 1983 regulations until June 2010 and will be able to continue to allot securities under prospectuses registered under the 1983 regulations for the life of the prospectus.

While the key change arising out of the 2009 regulations is the implementation of the simplified disclosure prospectus (SDP) regime heralded with the changes to the Securities Act 1978 that were made at the end of July, the Ministry of Economic Development (**MED**) has seized the opportunity to modernise the 1983 regulations and introduce a range of other amendments recommended by the Capital Market Development (**CMD**) Taskforce.

The new regulations incorporate changes to the regulations arising from MED's exposure draft of the SDP regulations released in May 2009 and MED's discussion document "Changes to the Securities Regulations" released in April 2009. (For further information on these discussion documents see the articles ["Fast track for capital raising: simplified disclosure prospectus"](#) and ["Proposed securities regulation changes released"](#) in the Autumn 2009 issue of Commercial Quarterly.) They also contain a number of other substantive and minor drafting changes which were not released for public consultation.

#### **Simplified disclosure prospectus**

The new SDP regime will provide a significant opportunity for listed issuers to reduce the compliance costs associated with capital raising by removing the duplication of disclosure of information that is already available to the market, typically by means of the issuer's announcements under the NZX continuous disclosure regime.

Specifically, use of an SDP provides for:

- Listed issuers who are already subject to continuous disclosure obligations being able to raise capital using one (simplified) disclosure document instead of a prospectus and an investment statement.
- Two alternative forms of SDP disclosure:
  - a very short form offer document ("SDP lite") for offers of securities of the same class as existing listed securities already on issue (relying heavily on continuous disclosure); and
  - a longer form offer document for offers of securities that rank equally or in priority to existing listed securities (which will be less reliant on continuous disclosure).

Listed unit trusts will also be able to use the SDP regime for offers of additional listed securities, and to offer higher ranking debt securities.

We are pleased to see that a number of restrictions and anomalies contained in the initial draft of the regulations proposed earlier this year have been addressed or removed altogether. In particular, the proposed distinctions between debt and equity securities have been removed, thereby reducing concerns about one type of security receiving a more favourable regulatory treatment than others.

However, an issuer seeking to make an offer of further (listed) securities by means of the SDP must also:

- identify the continuous disclosure information to draw the attention of investors to it;

- correct or update that continuous disclosure information if it is misleading in the context of the offer; and
- in the case of any material information that has not been disclosed pursuant to the issuer's continuous disclosure obligations, that is likely to assist would-be investors, make a statement to that effect.

Such disclosed information must also be made available for inspection. In addition, the directors of the issuer are required to state whether the issuer is in compliance with its continuous disclosure obligations.

Also absent from the SDP regime is the catch-all disclosure standard previously suggested by MED that the offer document contain all information that investors and their professional advisers would reasonably require to make an informed assessment of the offer (including information incorporated by reference to announcements made by the issuer under its continuous disclosure obligations).

We expect that issuers will continue to undertake a significant level of due diligence investigation to ensure that the issuer's directors can still rely on the due diligence defence provided by the Securities Act 1978. As a result, the use of an SDP is likely to reduce the level of duplication in disclosure information and achieve other savings but may not ultimately achieve a significant streamlining of the process of capital raising for a listed issuer.

### **Other changes**

Other changes incorporated in the 2009 regulations include:

- aligning the requirements for financial statements in prospectuses with generally accepted accounting practice;
- increasing the flexibility around the matters that may be included in securities advertising (including by enabling reference to information from interim and unaudited financial statements);
- changing the requirements governing the inclusion of prospective financial information in a (long-form) prospectus so that the requirement for a 12-month prospective statement of cashflows is replaced by a requirement to provide a full set of prospective financial statements unless the directors of the issuer conclude that doing so would be misleading;
- aligning the requirements for disclosing directors' and managers' interests across different types of issuer; and
- a modernisation and alignment of the language used in the regulations, particularly the disclosure schedules, which is the first substantive updating since the prospectus disclosure regime came into force more than 20 years ago.

### **Final thoughts**

While the 2009 regulations are a welcome adoption of the recommendations of the CMD Taskforce to reduce the hurdles faced by listed issuers when raising capital, it is suggested that the new regulations do not substantially lower the standards expected of businesses seeking to raise capital from the public. This is particularly the case for new issuers seeking to undertake an initial public offer – who must still use both an investment statement and a long-form prospectus.

Existing issuers are also likely to put their market announcements under the microscope and, judging by recent Australian experience, seek to remove any doubts about the extent of disclosure by updating the market perhaps by means of an Australian-style 'cleansing statement'.

The Minister has indicated that the 2009 regulations will be reviewed as part of a larger review of the Securities Act which was begun this year. It is likely that the outcome of this review will result in further refinements to the disclosure process. A detailed discussion document on the Securities Act will be released by the end of this year and new legislation is expected to be in place by the end of 2011.

**Further information**

Bell Gully is working on a detailed analysis of the Securities Regulations 2009. If you would like a copy of that analysis or further information about the new regulations or the SDP regime, please contact your usual Bell Gully adviser.

For a copy of the [Cabinet paper](#) on the changes to the 1983 securities regulations visit MED's website at [www.med.govt.nz/templates/StandardSummary\\_\\_\\_\\_41829.aspx](http://www.med.govt.nz/templates/StandardSummary____41829.aspx)

## Securities and capital markets

### Clear signals for future capital markets change – and more quick fixes now

*The Capital Market Development Taskforce, appointed by the Government last July, has released a progress report identifying major issues facing New Zealand's capital markets. It builds on its earlier interim report, released last December, adding to the list of quick fixes identified in the interim report and setting the scene for the likely recommendations to be contained in its final reports now due this December. In this article senior associate Stephen Layburn outlines the taskforce's latest recommendations.*

Taskforce chair Rob Cameron, in releasing the report, noted that the taskforce had big issues to deal with. Not only did it have to identify the issues affecting New Zealand's capital markets but also it spent most of the last year focusing on the development of urgent measures in response to the global financial crisis (GFC). Many of the issues identified by the taskforce are based on relevant industry data, from engaging with industry participants, and from specific commissioned research.

The taskforce has been mindful of the context against which it is reporting. Given the GFC has highlighted a number of deficiencies and vulnerabilities in capital markets generally, the taskforce considered it important to stand back from the GFC and think about how to use this as an opportunity to reshape our capital markets to better serve New Zealand. The progress report notes that it will be important that New Zealand has, and is recognised as having, a robust and certain regulatory regime. This is something the taskforce regards as important given New Zealand's large current account deficit making it critical that our markets are both attractive to international capital as well as being developed to be attractive to a higher levels of domestic savings.

#### The key issues

The taskforce believes that New Zealand can and should do much better, with many of the issues, identified as evidence that our capital markets are not functioning as well as they could, being matters it earmarks as being within our control. While it continues to develop recommendations for improvement, the primary issues it has identified include:

- **Thin public capital markets.** New Zealand's listed equity markets are described as being relatively small and illiquid with only limited participation by firms in a number of industries. There has been little growth in listings and relatively small amounts of capital raised when compared with Australia and markets further afield. While the attrition rate from the listed market is broadly in keeping with other countries, there have been comparatively few new listings. One feature of the New Zealand listed company market is the tendency to pay relatively higher dividends rather than retaining earnings for reinvestment. Despite the recent flurry of corporate bond issues, the short-term debt markets are dominated by banks with a small domestic corporate bond market largely comprised of infrastructure and SOE issuers with solid credit ratings.
- **Patchy private markets.** The economy is dominated by SOEs which have a higher reliance on bank debt and little access to alternative sources of external funding. New Zealand has one of the most bank-dominated financial systems in the OECD. As a result, some SMEs with high growth potential may be constrained by the availability of funding. Outside the public market, most capital is provided by families and individuals as well as retained earnings and institutions. Few participants rely on outside capital or even outside talent for governance. Also, that there are tensions on both sides of the market with owners sceptical about the benefit of public markets and often with little ambition to grow while investors find it difficult to access investment opportunities. While the private equity/venture capital market is developing, private equity fund raising activity is low, with few local investors participating and the private equity market suffering from the number of deficiencies.
- **Underdeveloped derivatives market.** Because of its size, the New Zealand economy is vulnerable to shocks affecting export and import prices, exchange rates, credit conditions and other economic risks. Derivatives provide a way to manage some of these risks. Despite the significance of the primary sector, the range of commodity derivatives is under-developed, making it difficult to manage risk (let alone for these tools to be used to contribute to the functioning of the underlying physical markets by improving liquidity and information flows).

- **Low levels of investment in capital market products.** Putting the low level of household wealth to one side, portfolio composition of New Zealand households is heavily weighted towards housing at the expense of other asset classes. New Zealand has low levels of financial asset holdings and is the only country in the nine OECD countries surveyed to experience a decline in the ratio of household net financial wealth relative to income over the 20 years. The composition of financial asset holdings is also heavily skewed towards low risk/high liquidity assets such as bank deposits and high risk debt. New Zealand households also have the lowest share of financial assets invested in equities. There are a number of reasons for these outcomes including over-investment in the housing sector, underdevelopment of pension funds and widespread mistrust of capital markets (and biases in tax settings).
- **Non-participation by many co-operatives, government-owned, foreign-owned and other entities.** A number of structural features reduce investment opportunities including:
  - significant New Zealand export industries based around co-operatives which have chosen not to participate in public equity markets;
  - some industries, such as utilities, having significant central and local government ownership;
  - many of New Zealand's largest companies are subsidiaries of foreign companies few of which choose to raise equity in New Zealand;
  - relative to its size, New Zealand is the headquarters for relatively few global size firms.
- **Poor regulation of financial intermediary/financial advisory sector.** A combination of factors led to finance companies being able to offer lower interest rates than were justified by their risks and engage in practices which raised those risks further. Lack of transparency about fees and the absence of independent supervision led to investor mistrust of managed funds. The Financial Advisers Act 2008 will help address some of these issues.
- **Outdated regulation and unnecessary compliance costs.** The announcement of a root and branch review of the Securities Act is welcomed as an opportunity to resolve the present difficulties of a high-cost disclosure regime which is perceived as providing little guidance for investors and stifles innovation and new entrants.
- **Inadequate analyst research coverage.** The chicken and egg-like relationship between the present low levels of analyst coverage and the cost of this research is noted. Research has been shown to improve liquidity and improve efficiency.
- **Clearing and settlement infrastructure.** The taskforce has commissioned an expert report to consider what system best suits our needs. The report is expected in September or October.
- **Tax settings.** There are concerns about areas where tax policy imposes barriers to capital market activity. Specific issues will be identified for consideration in the context of a wider review of tax policy.
- **New opportunities.** The GFC provides new opportunities and the taskforce is looking for ways in which New Zealand can leverage its competitive strengths to play a greater part in the market for international financial services.

### **Taskforce's final reports**

Perhaps the most interesting section of the progress report is that which signals that the taskforce's work to address some of these key issues. The taskforce will include recommendations in the following areas in its final reports:

- **Regulatory changes to improve investor outcomes in financial products and advisory markets.** There is a need to improve investor outcomes to generate activity and confidence in capital markets and that trust in issuers and advisers to treat investor ethically underpins outcomes. As a result, there is a need for more principles-based regulation focused on ethical standards for issuers and advisers, rather than black letter law which can be "arbitraged". The taskforce notes five objectives for regulation and specific areas of focus for improving investor outcomes (particularly in clarity and transparency of disclosures as well as the ability to access competent advice, improved investor education and early intervention powers by regulators). It sees the Financial Advisers Act as going a long way to fixing the ills of the advisory sector, noting implementation will be critical.

- **Improve regulation to reduce costs and uncertainty for issuers.** A further list of suggested changes, in addition to the interim quick fixes, are outlined (see table below). The taskforce intends to have input into the root and branch review of the Securities Act review and notes the need to look at the distinction between public and private securities offers and overhaul disclosure obligations.
- **Tax changes.** The taskforce seeks to remove barriers to capital market activity as part of a coherent tax system and will be reporting on tax issues and contributing to the efforts of the Government's newly established Tax Working Group.
- **Rethinking the role of government.** The taskforce has signalled that it sees a broader role as being appropriate for the Government in some areas, including by:
  - leveraging its existing role as a direct participant (through debt issues, SOEs, the NZ Super Fund and VIF);
  - leading innovation (through the Reserve Bank and KiwiSaver) perhaps encouraging greater industry research and exploring opportunities for New Zealand to attract a greater share of international financial services business;
  - negotiating in international markets to update tax treaties, and achieving further capital markets integration (but advantage New Zealand as a destination); and
  - reducing the extent of unwitting (negative) intervention – with the Overseas Investment Act being identified as having adverse consequences for companies and capital markets – which the taskforce is keen to provide further input about.

## Principles for improving investor outcomes

Proposal	Discussion
<b>Treating customers fairly</b>	
<ul style="list-style-type: none"> <li>• Require all firms participating in the retail investment market (issuers and advisers) to treat customers fairly</li> </ul>	<ul style="list-style-type: none"> <li>• Modelled on UK example</li> <li>• Principles based</li> <li>• Regularly policed</li> </ul>
<b>Financial advisers</b>	
<ul style="list-style-type: none"> <li>• Fiduciary duty to be imposed on financial advisers</li> <li>• Restrict the use of the label "independent adviser"</li> </ul>	<ul style="list-style-type: none"> <li>• Overseas (US/UK and some Australian) examples</li> <li>• Fundamental obligation to act in client's best interests (and address conflicts of interest)</li> <li>• Independence label governed by fee structures and absence of restrictions on providing advice on certain products</li> </ul>
<b>Product disclosure</b>	
<ul style="list-style-type: none"> <li>• Principles guiding what is effective product disclosure:           <ul style="list-style-type: none"> <li>○ timely, concise, explicit and accessible</li> <li>○ information provided up-front and jargon free</li> <li>○ standardised to enable comparison</li> <li>○ consider financial literacy of target audience</li> </ul> </li> <li>• Mandate one/two page disclosure document</li> </ul>	<ul style="list-style-type: none"> <li>• Principles to govern the review of disclosure regime</li> <li>• Simple document aimed at less sophisticated investors, using standardised requirements</li> <li>• Replace the investment statement (which has not achieved its purpose)</li> </ul>

- More standardised fees disclosure
- Centralised website for disclosure documents
- Greater uniformity of fees disclosure, allowing meaningful comparisons
- Centralised disclosure to enable better use of comparisons

### Managed funds

- Concerns about ownership structures
- Principle-based disclosure requiring declaration that trustees/directors/managers have done nothing to further their interests or those of the fund at the expense of individual members
- Ongoing enquiry about appropriateness of fund structures
- Disclosure may be addressed in the context of (generic) principles-based disclosure.

## Summary of recommendations to reduce cost of capital raising for small companies and private markets

Proposal	Impact	Ease of implementation
<b>Changes to the Takeovers Act/Takeovers Code</b>		
<ul style="list-style-type: none"> <li>• Ensure that joint shareholders are counted as a single shareholder in determining whether the Code applies to unlisted firms and reinstate \$20 million asset minimum.</li> </ul>	High	Medium
<ul style="list-style-type: none"> <li>• Remove the need for independent adviser's report for small firms (if the first point not implemented).</li> </ul>	Medium	Medium
<b>Changes to the Securities Act 1978</b>		
<ul style="list-style-type: none"> <li>• Remove the need for exemptions to be gazetted (consistent with Takeovers Panel).</li> </ul>	Low	Easy
<ul style="list-style-type: none"> <li>• Allow filing of section 37A(1A) certificates to extend prospectus if material adverse change to financial position.</li> </ul>	Medium	Medium
<ul style="list-style-type: none"> <li>• Remove restrictions on pre-prospectus publicity.</li> </ul>	Low	Medium
<ul style="list-style-type: none"> <li>• Create statutory exemption for employee share schemes.</li> </ul>	Medium	Medium
<ul style="list-style-type: none"> <li>• Remove voiding of (non-public) offers where taken up by a single member of the public.</li> </ul>	Low	Medium
<ul style="list-style-type: none"> <li>• Certification of a wealthy person should occur at any time in 12 months pre-subscription (rather than prior to offer).</li> </ul>	Low	Easy
<ul style="list-style-type: none"> <li>• Allow \$500,000 minimum subscription to be paid in instalments.</li> </ul>	Medium	Easy

- Remove vendor shareholder liability in IPO exits. Medium Medium

#### Changes to the Securities Regulations and Exemption Notices

- Amend the venture capital scheme exemption to increase range of issuers and the (financial) cap. Low Easy

#### Changes to the Limited Partnerships Act 2008

- Clarify a limited partnership formed by re-registering a special partnership succeeds to the rights and liabilities of the special partnership. Low Easy

#### Next steps

The taskforce will issue further reports on the issues in the progress report, incrementally as they are completed.

To access a copy of the [CMD Taskforce's July 2009 Progress Report](#) visit the Ministry of Economic Development's website at [www.med.govt.nz](http://www.med.govt.nz)

## Securities and capital markets

### Changing regulatory functions at issue for New Zealand and Australian exchanges

*In this article, senior associate Stephen Layburn discusses NZX's proposals to reallocate some of its capital markets regulatory functions as set out in a discussion document prepared for the Capital Market Development Taskforce.*

NZX proposals to reallocate some of its capital markets regulatory functions are the latest measures up for discussion on the agenda for market improvements.

The Capital Market Development Taskforce (CMD Taskforce) released a discussion document prepared for it by NZX in the government-appointed group's ongoing efforts to boost New Zealand's capital markets and make it easier for business to raise capital.

In releasing the discussion document taskforce chair Rob Cameron noted that there is a global debate about the optimal scope and role of exchanges and regulatory functions. NZX undertakes a range of regulatory functions, some of which are inherent for an exchange, he said, but any analysis of specific regulatory function should be assessed against a clear and rigorous set of principles. Those principles would allow the taskforce to undertake a uniformed analysis across the entire regulatory landscape.

NZX uses the discussion paper to describe the legislative and capital market context in which it undertakes its regulatory activities and then outlines a suggested framework for assessing its regulatory structure and the apportionment of roles across regulators. Using that groundwork it then assesses its various regulatory functions against the proposed framework and proposes a set of changes for the re-allocation of some regulatory functions.

NZX notes that there are a myriad of ways in which the allocation of regulatory functions and their enforcement are managed globally with no single "best practice model" evident, suggesting the need for tradeoffs.

The discussion paper identifies seven key structural principles NZX believes should drive the design of the regulatory framework and the allocation of responsibilities and accountability. It also highlights the need to observe practical criteria, such as responsiveness and robustness.

In its scorecard, NZX says it remains comfortable with its current set of regulatory and market supervision responsibilities and its discharge of them, noting that, overall, there are no "burning platform" catalysts for change. Instead, it sees a fundamental rewrite of the Securities Act as the more important near-term priority. Also, it says that many of the issues that have imperilled investor outcomes, stymied productive innovation, and stunted the growth of capital markets can be traced to the obsolete nature of the Securities Act.

#### **NZX's proposed changes**

NZX suggests under certain circumstances some of its regulatory functions may be better discharged by other existing or new regulators. Five proposed changes are identified:

- *Removing from supervision the advice component of NZX Participants (typically stockbrokers) - with that function being moved to the Securities Commission, as a result of the recent legislative changes making the Commission a universal regulator of client advice.*
- *Removing from supervision prudential capital and client fund areas for NZX Participants - with that role to be filled by the Reserve Bank as a logical extension of its new role as supervisor of non-bank deposit taking activities.*
- *Consolidating the approval of offer documents between the Securities Commission and the Companies Office - with NZX's role clarified and limited to Listing Rule issues (to the extent that they differ from the legislative requirements).*

- *Removing the current enforcement function* - with it moving to either the Securities Commission or a newly formed special purpose body to take over the role currently undertaken by NZX-established but independent operating Markets Disciplinary Tribunal.
- *Clarifying the scope and remit of oversight reviews* – a role now undertaken by the Securities Commission in relation to NZX only. Potentially this role could be extended to other statutory and other non-statutory regulators.

While the CMD Taskforce does not propose a formal timeline and process for commenting on the discussion document, it will be interesting to see whether some of the commentators who have been particularly critical of NZX will respond. In doing so, the question remains whether those commentators will address NZX's strongly-worded rebuttal of recent criticism that its commercial operation is in conflict with its regulatory role. In that rebuttal, NZX makes the rather compelling point that the assertion that it would use its regulatory role to manipulate commercial outcomes is unsupported and ultimately unsustainable.

Equally compelling is the case that NZX makes for continuing with its approach of principles-based regulation (such as that contained in the existing NZX Listing Rules and the process for obtaining waivers from those rules) when contrasted against a 'black letter law' approach, which NZX describes as inflexible.

### **Developments across the Tasman**

It is interesting to note that the discussion document was published on the same day the Australian Government announced that it will move to take away supervision of Australia's largest licensed brokers from the Australian Securities Exchange (ASX). This move, which includes removing the ASX's role in the Sydney Futures Exchange, will see those supervisory functions shifted to the Australian Securities and Investments Commission (ASIC).

ASIC's role is also extended to include the current powers of ASX to detect market abuses such as insider trading. Currently, ASX is responsible for detecting suspected breaches and then referring them to ASIC for follow up, including prosecution.

ASX's ability to effectively supervise market participants (licensed brokers) has been questioned after the failure of two large Australian brokerages, in which it emerged that one of the brokers had not met a principal regulatory requirement for more than two years.

Changes would leave ASX with its supervisory role for listed companies. It is also described as opening the door to potential competition to the ASX from other market operators, including an entity which is part-owned by NZX.

The changes in Australia are due to come into effect in the third quarter of 2010.

To access a copy of the ["The allocation of certain regulatory functions across New Zealand"](#) visit the Ministry of Economic Development's website at [www.med.govt.nz](http://www.med.govt.nz)

## Securities and capital markets

### Recent developments affecting finance company activities

*In this update, senior associate Stephen Layburn discusses four recent developments which impact on the finance company sector, namely: the extension of the retail deposit guarantee scheme; a proposed new licensing regime for corporate trustees who supervise debt issuers (including finance companies); the introduction of regulations which will simplify and clarify disclosure obligations for finance company moratorium proposals by the end of the year; and the Commerce Select Committee's inquiry into finance company failures.*

#### **Extension of retail deposit guarantee scheme**

In August, the Government announced a 14-month extension to the retail deposit guarantee scheme, together with a number of proposed changes to the scheme's terms and conditions. (See the article [Crown Guarantee Scheme - an overview](#) in the Spring 2008 Commercial Quarterly for details on the current scheme.)

The announcement of the extension of the retail deposit guarantee scheme has ended speculation about the fate of the current scheme, which ends in October 2010 and, once enacted, will bring the arrangements in New Zealand closer to Australia's extended deposit guarantee scheme.

The extension (described by the Government as a new scheme) will run until 31 December 2011 and has the stated objective of continuing the original objectives about maintaining stability and confidence in New Zealand's financial institutions whilst seeking to remove some of the distortions inherent in the current scheme. It also addresses concerns about the allocation of the costs of the scheme.

Finance Minister Bill English says the extension will help financial institutions achieve "an orderly exit from the scheme" and "allow both depositors and financial institutions to adjust back to a more normal business environment".

The changes announced by the Minister that will take effect under the extended (new) scheme are:

- A requirement for participating deposit-taking institutions to have a credit rating of BB or higher whereas those institutions with a lower credit rating (or no rating) will not be eligible despite being included in the current scheme.
- A change to the fees paid by participating institutions to reflect their risk profile (effectively the lower the credit rating the higher the fees payable). These fees are described as being intended to approximately match longer term normal market pricing. Thresholds in the current scheme will be discontinued and the fees will apply to all funds in the new scheme.
- A reduction in the level of coverage, from the maximum under the current scheme of \$1 million per depositor per institution, to:
  - a maximum \$500,000 per depositor per institution for eligible bank deposits; and
  - a maximum \$250,000 per depositor per institution for eligible non-bank deposits.
- Collective investment schemes will not be eligible under the new scheme.

When announcing the extension, the Minister noted that some institutions may choose not to apply for coverage under the extended scheme whilst others will not meet the application criteria. Further, as credit conditions improve some financial institutions also may decide that participation is not worthwhile.

Since the Minister's announcement, market commentary has been mixed with concerns being voiced that by simply following Australia and not extending the scheme for a longer period, the Government risks jeopardising the long-term survival of a sector that may prove to be vital for SMEs as they emerge from the recession. In particular, it seems likely that the major trading banks will opt out of the scheme because they will no longer need it. At the other end of the spectrum, a number of smaller finance companies will not achieve the minimum credit rating requirement.

Those commentators who express concern that the scheme should be continued for longer point to distinctions between Australia and New Zealand and the significance of the non-bank finance sector as a source of expansion capital for SMEs, particularly given the likelihood that the de-leveraging exercise being undertaken by the major banks may see New Zealand SMEs more reliant on finance company funding.

Given the present difficulties being encountered by finance companies in seeking to realise assets taken as security, concerns have been expressed that by effectively requiring this process to have been completed by December 2011 the Government may not be allowing sufficient time for a recovery of both the profitability and confidence that will be needed to enable finance companies to go to the public for deposits without the safety net of the government guarantee.

On the other side of the ledger, others point to the steps being taken by some of the major finance companies to sure-up balance sheets through injections of capital by shareholders and express concern that the taxpayer should not be taking on the risk of the smaller firms.

Legislation will need to be introduced to enact the changes to the current scheme, which are to take effect from 12 October 2010.

### **New regime for corporate trustees and statutory supervisors**

On 26 August, Commerce Minister Simon Power announced that the Government has agreed to a new regime for corporate trustees and statutory supervisors who supervise debt issuers and some collective investment schemes.

The new regime, will involve the licensing of trustees by the Securities Commission, and a range of measures to strengthen the quality of supervision provided by trustees.

In making the announcement, the Minister said that the recent collapse of a large number of finance companies has raised some fundamental issues around the role of corporate trustees, and in particular the competency and accountability of some trustees. Consequently, he said, the new regime will ensure that trustees are suitably qualified and have rigorous systems and processes in place to protect the interests of investors.

Central to the new regime is the removal of the automatic right for trustee corporations to supervise issuers of debt and some collective investment schemes. Instead, trustees will be licensed by the Securities Commission which will have the power to tailor licences so trustees have processes in place that are in proportion to the level of risk associated with the issuers they supervise. It is understood that, in doing so, the Commission will take into account matters such as the trustee's competence, systems and processes for supervising issuers, and financial strength.

Additional measures to improve the quality of supervision provided by trustees, referred to by the Minister include:

- enhanced powers of enforcement against trustees who fail to comply with their duties;
- greater prescription around matters that must be addressed in trust deeds;
- mandatory reporting by trustees to the Commission when issuers of securities may be nearing default; and
- enabling the Commission to direct trustees to take action against issuers.

The Minister also noted that the new regime, whilst contributing to ensure that trustees' supervision of debt issuers and some collective investment schemes is effective and protects investors, would not impose unnecessary compliance costs. He added that mandatory reporting by trustees to the Securities Commission will help ensure proactive action is taken to protect investors' interests.

Legislation is expected to be ready for introduction to Parliament by the end of the year.

### **Finance company moratorium proposals**

Commerce Minister Simon Power also announced in August the pending arrival of regulations to govern disclosure obligations for finance company moratorium proposals. In simple terms, these moratorium proposals provide investors with a choice between a moratorium (forgoing interest or principal repayments

(or both) for a period of time) and a receivership. To date moratorium proposals have been used by 12 finance companies with approximately \$2 billion involved.

The Minister has said the regulations will ensure that key information is available to investors who are being asked to decide whether to approve a moratorium proposal affecting their investments. At present those decisions are the subject of what he described as onerous and highly complex disclosure documents. Instead, the new regulations will require debt issuers to provide clear and concise investment statements about moratorium proposals, along with independent expert advice, the views of the trustees, and the considerations of the company directors.

Central to the new disclosure regime are concerns that the material currently being circulated does not provide investors with the appropriate information to make sound decisions. (For details on the current requirements for moratorium proposals see the article [Moratorium proposals: what do investors need to know?](#) in the Summer 2009 Commercial Quarterly.) As a result, the new regulations will seek to ensure that the right information is made available in a transparent and easy-to-understand way.

### **Inquiry into finance company failures**

On 20 August, the Commerce Select Committee, chaired by former Minister of Commerce Lianne Dalziel, initiated an inquiry into finance company failures. The committee announcement referred to four areas which, it said, did not appear to have been addressed by previous and current government programmes.

The four broad areas identified are aimed at ensuring:

- investors are well-informed about investment proposals;
- investors understand the implications of a moratorium proposal before voting;
- advance actions can be taken to reduce the chances of failure; and
- adequate measures for redress exist when failures occur.

Based on these areas, the committee has set the following terms of reference for the inquiry:

1. To examine the quality of information provided to investors when considering an investment decision and investors' ability to understand financial matters. This workstream includes an examination of the role of marketing and advertising of investment proposals, adequacy of disclosure (particularly about advisers' commissions) and investor education issues.
2. To examine the quality of advice provided to investors in moratorium situations, including independent analysis of moratorium versus receivership and the independence of the management of the moratorium.
3. To examine ways of minimising the chances of situations arising where the risk of failure is not adequately reflected in the risks identified to investors or the returns investors expect to receive for that level of risk. This workstream includes examining the power of regulators to "call in" particular products that may raise investor protection issues, extended whistle blower protections and whether directors and managers implicated in "inappropriate activity" should be able to start up new firms.
4. To examine the measures in place that provide redress to investors where failure occurs and wrongdoing is established, particularly whether these measures act as a significant disincentive for wrongdoing to occur. This workstream includes questions about the holding of appropriate professional indemnity insurance, the tracing of funds following a collapses and the scope for "busting" asset protection trusts set up by culpable directors.

At first glance, the terms of reference are an unusual mixture of matters that cut across work being undertaken by the Ministry of Economic Development in its 'root and branch' review of the Securities Act as well as the proposals for regulation of disclosure requirements applying to finance company moratorium proposals (noted above).

Since the select committee's announcement, there have been reactions from market commentators to the effect that much of the content of the terms of reference are populist and a reaction to the lobbying of finance company activist Suzanne Edmonds (who petitioned for a Royal Commission of inquiry to investigate the finance companies crisis).

Whilst there is some merit to the concerns being raised about the width of the terms of reference for the inquiry and risk that considerable time and effort will be taken up addressing issues which will not be

solved overnight (such as the relatively low levels of financial literacy amongst the investing public), there is no doubt that the failure of so many finance companies has impacted a large sector of the public.

Therefore, there is a view that while it may be less than perfect, the inquiry provides those affected with an opportunity to share their concerns and perhaps, as a result, may achieve a greater degree of buy-in to the findings and any recommendations which may result.

Contrast this approach to the Russell inquiry in the aftermath of the 1987 sharemarket crash, which did not provide the same level of transparency and was later criticised for producing a series of findings which were self-evident and recommendations which were quickly forgotten.

The select committee inquiry is likely to run for some time. As a first step, submissions on the terms of reference are required by 15 October 2009.

**For further information on any of the above items please contact your usual Bell Gully adviser.**

## Securities and capital markets

### Takeovers Panel considers class exemption for rule 16(b)

*In August, the Takeovers Panel released a consultation paper on whether to grant a class exemption from rule 16(b) of the Takeovers Code. The paper discusses the Panel's current approach in granting specific exemptions from rule 16(b), the appropriateness of granting a class exemption and the possible terms and conditions of a class exemption.*

Rule 16 of the Takeovers Code specifies the information required for a shareholders' meeting notice relating to a proposed resolution for an allotment of voting securities which result in a shareholder holding or controlling (together with their associates) more than 20 percent of the total voting rights in a code company. Rule 16(b) requires the notice of meeting to contain, or be accompanied by, disclosures of the exact number and percentage of voting securities to be allotted and the exact percentage of voting securities that would be held by the allottee after the allotment. Often it can be impossible for the code company to specify the exact numbers and percentages required to be disclosed under rule 16(b) because that information is dependent on a number of factors outside of the company's control.

So far, the Panel has granted 35 exemptions from rule 16(b) and has rarely, if ever, declined any exemptions sought. Rule 16(b) exemptions represent nearly 20 percent of all exemptions granted by the Panel and result in a considerable time and cost burden on the resources of the Panel, the applicant allottee(s) and the code company.

The Panel has proposed the following four options for consultation:

- 1) retain the status quo, with the Panel continuing to consider exemptions on a case by case basis;
- 2) amend the Code to enable potential maxima to be disclosed in the notice of meeting;
- 3) grant a class exemption from rule 16(b) of the Code so that where the exact numbers and/or percentages required to be disclosed under rule 16(b) are unknown, the potential maxima must be disclosed; or
- 4) grant a class exemption from rule 16(b) of the Code (as in option 3) but require an additional level of approval by the Panel to determine whether a particular proposed transaction falls within the exempted class.

The Panel's preferred options are either of option 3 or option 4. That is, that the Panel grants a class exemption from rule 16(b) of the Code, with, or without, Panel approval on a case-by-case basis of the transactions that may fall within the exempted class.

If the Panel grants a class exemption from rule 16(b), the Panel notes that they would also consider whether the exemption should be a short term solution until the Code is amended to enable maxima to be disclosed in the notice of meeting.

Submissions on the Panel's proposals close on 2 October 2009.

To access a copy of the [consultation paper](http://www.takeovers.govt.nz/publications/class-exemptions/index.html) visit the Takeover Panel's website at [www.takeovers.govt.nz/publications/class-exemptions/index.html](http://www.takeovers.govt.nz/publications/class-exemptions/index.html)

## Securities and capital markets

### **NZX rule consultation for new clearing and settlement systems**

*Over the last 18 months, NZX has been working on implementing new clearing and settlement systems and infrastructure for its core trading markets and it has now released six consultation memoranda on changes required to implement the new system. NZX is also taking the opportunity to bring its corporate action entitlement processing in line with international best practice.*

#### **Overview**

For NZX's new clearing and settlement system to become operational, and also to become a designated settlement system under the Reserve Bank of New Zealand Act 1989, among other things, the settlement system is required to have rules which govern the basis on which settlement instructions are given or received, settlement obligations are determined, calculated and effected, as well as rules which govern the action of those responsible for these functions.

The rules for the designated settlement system will be constituted by the Clearing and Settlement Rules, the New Zealand Depository Limited Operating Rules and (in part) the New Zealand Markets and Disciplinary Rules. However, changes are also required to the NZX Participant Rules, NZSX/ NZDX and NZAX Listing Rules and the NZ Markets Disciplinary Tribunal Rules and Procedures to reflect the new clearing and settlement arrangements.

The six consultation memoranda on the new clearing and settlement system provide:

- an overview of the new settlement system and the relevant rules governing the entities interacting with NZX's markets and the inter-relationship between those rules;
- a more detailed description of two new rule sets relating to the clearing and settlement system, the Clearing and Settlement Rules and Procedures and the Depository Operating Rules and Procedures; and
- the amendments required to the existing NZSX/NZDX and NZAX Listing Rules, NZX Participant Rules and the NZ Markets Disciplinary Tribunal Rules and Procedures.

NZX has also released the relevant rules and procedures to which the memoranda relate.

A brief overview of the proposed amendments to the existing NZX Participant Rules and NZSX/NZDX and NZAX Listing Rules is outlined below:

#### **NZX Participant Rules**

The NZX Participant Rules require amendment as a result of the implementation of the clearing and settlement system, both to reflect the removal of current provisions relating to clearing and settlement and to align the NZX Participant Rules with the proposed Clearing and Settlement Rules and Depository Rules. NZX also proposes amendments in four further areas:

- to permit, but not require, NZX to maintain a Fidelity Guarantee Fund;
- the Rules relating to bringing orders to market, crossings and off-market trading by NZX Participants which are designed to increase the volume of price discovery activity on the trading platform making the "onscreen" price and volume most representative of the value of a security at a given time;
- the Rules relating to error trade reporting and cancellation of trades (both on market and off market). The main difference between the current Rules and the proposed Rules is the recognition that with anonymous trading, NZX intervention will be necessary to cancel on-market trades. The proposed Rules also clarify the circumstances when a trade or crossing may be cancelled due to error; and

- the Rules relating to capital adequacy requirements for NZX Participants which are consistent with the capital adequacy requirements for Clearing Participants under the Clearing and Settlement Rules (although the minimum amount of capital required is less).

### **NZSX/NZDX and NZAX Listing Rules**

The NZSX/NZDX and NZAX Listing Rules also require amendment to remove references to the current Clearing and Settlement System. Additionally, NZX wishes to take the opportunity to bring NZX's corporate action entitlement processing in line with international best practice and proposes the following:

- **New Ex Date and rights issues:** Amending the Ex Date for all entitlements for Quoted Securities to be the second business day before the Record Date for that entitlement (i.e. three full trading days) rather than NZX's current practice of the Ex Date being the first business day after the Record Date which is considered by the NZX to be administratively unwieldy for market participants and out of alignment with international practice.

This amendment will also affect the number of trading days between the announcement of a benefit and the Ex Date for that benefit. In the case of a rights issue, the change means there would only be two Business Days (instead of the current five Business Days) on which to trade on the announcement (given that, an Appendix 7 must be released to NZX at least five Business Days before the Record Date). As NZX believes that two Business Days is not sufficient time for trading to occur between the announcement of a rights issue and the Ex Date for that rights issue, NZX proposes to amend the Rules relating to the release of information about rights issues to require the release of the details of a rights issue no later than five Business Days before the Ex Date for the rights issue.

- **Corporate action announcements:** To require issuers notifying the market of a dividend to include in that notification the amount of foreign dividend payment credits attaching to the dividend per share. Listed PIEs will also be required to state the amount of dividend that is excluded income per share. These amendments are being made as a result of feedback received by NZX.

### **Next steps**

Submissions on the memoranda and rules closed on 2 September 2009. The Clearing and Settlement Rules, the New Zealand Depository Limited Operating Rules and the New Zealand Markets and Disciplinary Rules will be approved in the course of the designation process and NZX has indicated that it will send the changes to the Conduct Rules to the Minister of Commerce on 1 October 2009 (which would mean a likely implementation date in late November 2009).

To access a copy of the [memoranda and rules](http://www.nzx.com/market-supervision/rules-consultation) visit [www.nzx.com/market-supervision/rules-consultation](http://www.nzx.com/market-supervision/rules-consultation)

## Competition and consumer law

### **The correct way to fail**

In this article, partner Torrin Crowther discusses the Commerce Commission's draft supplementary guidelines on how merger and acquisitions applications involving the 'failing firm' argument will be treated.

### **Commission signals start to implementing new regulatory processes**

In this article, senior associate David Blacktop outlines four discussion documents which represent the start of the process of implementing the new regulatory processes in the amended Part IV of the Commerce Act. The discussion documents cover "input methodologies" - the underlying building blocks for implementing regulation under Part IV, the Commerce Commission's revised guidelines on estimating cost of capital, resetting the price path thresholds for electricity distribution businesses (EDBs) and how price-quality thresholds should apply to Transpower.

### **Commerce Commission's powers under scrutiny in Supreme Court**

In this article, senior associate Jenny Stevens reviews the Supreme Court's first decision over the lawfulness of the Commerce Commission's use of information-gathering section 98 notices - which held that the Commission overstepped its powers in a pharmaceutical industry investigation.

### **Court confirms New Zealand jurisdiction in overseas resident proceedings**

In the first appellate consideration of extra-territorial jurisdiction under the Commerce Act 1986, the Court of Appeal has dismissed appeals from a High Court decision that the New Zealand courts have jurisdiction to hear proceedings against three overseas residents.

## Competition and consumer law

### The correct way to fail

*In this article, partner Torrin Crowther discusses the Commerce Commission's draft supplementary guidelines on how merger and acquisitions applications involving the 'failing firm' argument will be treated.*

The Commerce Commission has recently released draft supplementary guidelines on how merger and acquisitions applications involving the 'failing firm' argument will be treated.

In competition law-speak the 'failing firm' theory refers to situations when clearance is sought on the basis the vendor is failing or has a failing division, and absent an acquisition its assets will leave the market. The argument is that the "factual" (the world with the acquisition) and the "counterfactual" (the world without the acquisition) will be the same and hence there will be no substantial lessening of competition as a result of the acquisition.

The theory sounds simple enough but in the formal clearance context, the Commission needs to be "satisfied" the business is likely to fail, there are no alternative buyers and the target's assets will not otherwise constrain the firm seeking a clearance. Moreover, the Commission's position is that in order for a clearance to be granted on this basis, it must be satisfied that this outcome will occur under each "likely" counterfactual, of which there may be more than one.

While there have only been a few successful failing firm applications since the 1990's – the most recent in February this year when the Commission granted a clearance for Fletcher Building to acquire certain parts of Stevenson's masonry business – the expectation was that there would be an increase given the economic climate. Although the Commission's current Mergers and Acquisitions Guidelines outline a general approach to failing firms in the clearance context, an expected increase in the number of failing firm applications prompted the Commission to provide more specific guidance for the business community on how it would assess these applications, and in particular around what information should be provided to the Commission. As it has turned out there have been no failing firm applications since the Stevenson transaction earlier this year although that's not to say we won't see any more in the current economic cycle.

Commerce Commission Chair Dr Mark Berry has said that normal competition analysis will still apply to deals involving failing firms and the Commission will not be relaxing its standards when considering such cases. *"However, the Commission recognises that it is useful for businesses to have clear guidance on the supporting evidence that the Commission will need to assess this type of application,"* he said.

The guidelines state that when considering a failing firm argument, the Commission will take into account a number of factors in assessing whether, on the evidence, failure appears to be actual, imminent or probable. This will include an assessment of whether the firm is actually failing based on negative cash flow trends over time and whether any attempts have been made to restructure or rescue the business. It will also involve consideration of whether there is an alternative third party purchaser and whether, on closure, the assets of the firm will exit the market.

The Commission acknowledges that if a firm is genuinely failing, time will be of the essence. The guidelines state that: *"Providing relevant, complete and robust information when a failing firm argument is made would assist the Commission in making this assessment quickly."*

They are intended to lay out the range of information that the Commission would need in order to make a timely assessment. Consistent with the Commission's current approach of requesting, and placing substantial weight on, internal company documents (in 'normal' as well as failing firm applications), the guidelines state that the Commission will be assisted by the provision of material such as management accounts, board papers and minutes and internal strategic plans concerning the viability of the business, and evidence of bona fide efforts to sell the business as a going concern or its assets on closure.

While the speed with which a failing firm will need to find a suitor will often mean there is insufficient time to undertake a traditional full sales process (i.e. involving a detailed information memorandum, indicative bids, full due diligence etc.) firms should nevertheless expect to be required to show that, having regard to the circumstances, they made proper efforts to find an alternative buyer. Internal company documents, as well as clear analysis as to why any potential bidders were dismissed as realistic buyers by the vendor, will be important. This is particularly so given that many firms will often express an 'interest' in acquiring a

business, notwithstanding that there may be little prospect of them actually being inclined (or able) to conclude a transaction when it comes to signing on the dotted line.

While firms can expect that internal documents will be afforded significant weight – particularly where they relate to the company's intentions in the counterfactual – the Commission will invariably want to separately test any such analysis.

The new guidelines bring greater transparency in terms of the information that businesses need to proactively provide (and if not, be prepared to provide when it is requested) when advancing a failing firm argument. However, as is standard with all guidelines, the failing firm guidelines include the caveat that the circumstances around claims that a firm is failing will be varied and each case must be assessed on its own facts.

The Commission is currently reviewing feedback from interested parties on the draft guidelines after which a finalised version will be published.

*This article was first published in NZLawyer, 21 August 2009.*

## Competition and consumer law

### Commission signals start to implementing new regulatory processes

*In this article, senior associate David Blacktop outlines four discussion documents which represent the start of the process of implementing the new regulatory processes in the amended Part IV of the Commerce Act. The discussion documents cover "input methodologies" - the underlying building blocks for implementing regulation under Part IV, the Commerce Commission's revised guidelines on estimating cost of capital, resetting the price path thresholds for electricity distribution businesses (EDBs) and how price-quality thresholds should apply to Transpower.*

As recognised by new Commerce Commission Chair Dr Mark Berry, "a major driver of the legislative change was the desirability of increasing regulatory certainty for suppliers because it fosters efficient investment". The publication of these four discussion documents "marks our first major milestone towards reducing uncertainty".

#### **Input methodologies and estimating the cost of capital**

The input methodology process was the core reform designed to improve certainty and predictability for regulated businesses. The process requires the Commission to develop and publish certain binding "building block" methodologies covering:

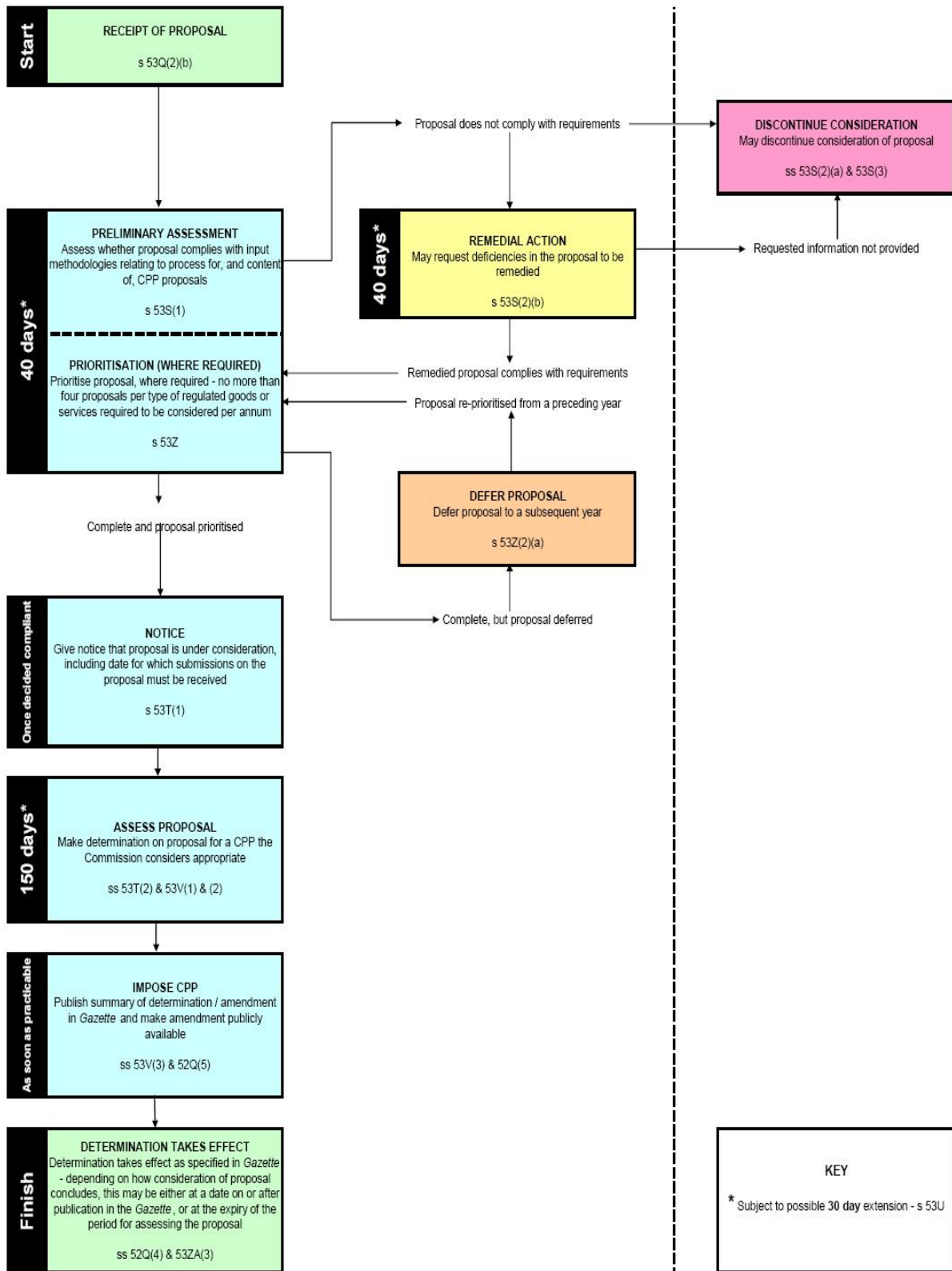
- methodologies for evaluating or determining:
- cost of capital;
- valuation of assets, including depreciation, and treatment of revaluations;
- allocation of common costs, including between activities, businesses, consumer classes, and geographic areas;
- treatment of taxation;
- pricing methodologies;
- regulatory processes and rules; and
- matters relating to customised price-quality path proposals.

The discussion paper (which is in excess of 500 pages) sets out general principles and then applies them to each industry subject to regulation (i.e., EDBs, Transpower (when regulation takes effect), gas pipelines businesses, and airports).

The Commission started reviewing its approach to estimating the cost of capital in 2006 before the Commerce Act was amended. The project has involved a detailed review by a panel of experts retained by the Commission (Professor Julian Franks of London Business School, Dr Martin Lally of Victoria University of Wellington and Professor Stewart Myers from MIT's Sloan School of Management.) The outcome of this process is set out in a companion paper and is being consulted on as part of the input methodology process.

As well as the more technical building blocks, the input methodology discussion document sets out the Commission's preliminary views on the process EDBs and gas pipelines businesses would have to follow if they sought to have customised price-quality thresholds applied. The Commission's preliminary view on the process for considering customised price-quality thresholds proposals is reproduced below.

# Process for Considering CPP Proposals



As this shows, the process will not be quick. The key initial decision point would revolve around whether the application complies with the input methodologies the Commission will put in place for a customised path. The Commission's preliminary view is that a full bottom-up review of the supplier's business may be appropriate for customised price-quality paths. As part of the type of information that will be required, the Commission has published an accompanying expert report from Farrier Swift setting out preferred approaches to reviews of capital and operating expenditures.

While these documents contain a lot of information, the input methodologies are critical to the way in which the Commission will implement regulation. Input methodologies might not be reset for another seven years, i.e, until 2017.

### **Reset of default price-quality path for Electricity Distribution Businesses**

The default price path-quality paths for EDBs reflect an evolution of the current price path thresholds regime.

The Commission has indicated its preliminary view is that the CPI-X regime will continue. However, importantly it has indicated its intention to closely examine the starting prices for EDBs. The Commission intends to use the prices as at 31 June 2010 as the initial starting prices and then review EDB profitability with a view to applying a subsequent price adjustment via a claw-back. This has the potential to undermine some of the certainty the reforms were designed to achieve.

The quality thresholds will likely be based on a no material deterioration in the three-year moving average System Average Interruption Frequency Index (SAIFI) and System Average Interruption Duration Index (SAIDI) from average levels that were recorded over the 2005-2009 regulatory period.

Submissions are due by 17 July 2009 and the Commission has indicated a draft decisions paper will be published in September.

### **Transpower process and recommendation discussion paper**

Transpower's pricing behaviour is subject currently to the administrative settlement it entered into with the Commerce Commission on 13 May 2008, following breaches of Transpower's previous thresholds. This settlement remains in place until 30 June 2011.

Before that date, the Commission must make a recommendation to the Minister specifying whether Transpower should be subject to default price thresholds or customised price path thresholds.

Sensibly, given the NZ\$3b in investment Transpower is planning to undertake over the next five years, the discussion document indicates that the Commission's preliminary view is that Transpower should be subject to a customised price path threshold.

In terms of the relationship between the Commission and the Electricity Commission (responsible for approving Transpower investments under the EGRs), the Commission's proposal is to include approved projects into Transpower's revenue requirement and that requirement would be updated as projects are approved. To provide safeguards against overcharging (or undercharging), at the end of a regulatory period future revenues could be adjusted having regard to previous under or over recovery.

### **Consultation process**

Final submissions on the consultation documents closed on 28 August 2009. As a further part to the consultation process the Commission is proposing to hold a conference on the input methodologies in the week of 15 September 2009. The Commission also plans to hold a separate workshop relating to the cost of capital with interested parties in November 2009.

### **For more information please contact:**

[David Blacktop](#)  
Senior Associate

[Andrew Brown](#)  
Partner

[David Cooper](#)  
Partner

[Torrin Crowther](#)  
Partner

[Garry Downs](#)  
Partner

[David Flacks](#)  
Partner

[Chris Gordon](#)  
Partner

[Amon Nunns](#)  
Senior Associate

[Ralph Simpson](#)  
Partner

[Clive Taylor](#)  
Partner

## Competition and consumer law

### Commerce Commission's powers under scrutiny in Supreme Court

*In this article, senior associate Jenny Stevens reviews the Supreme Court's first decision over the lawfulness of the Commerce Commission's use of information-gathering section 98 notices – which held that the Commission overstepped its powers in a pharmaceutical industry investigation.*

The court struck down the notice in the case, in a decision that has possible implications for other commercial parties, particularly against the backdrop of a proliferation of statutory notices being issued by the Commission over recent times.

Many companies at the centre of investigations have found it easier to simply comply with these formal requests for information and documents even when there have been serious concerns as to scope. The Supreme Court's decision helps to clarify the scope of the power and the circumstances in which that power can be successfully challenged.

#### **The central issue**

The issue before the court was whether a notice issued by the Commission under section 98 of the Commerce Act 1986 seeking certain information from AstraZeneca Limited was valid.

The Commission issued the notice after it became aware from the media that AstraZeneca may have sought to "tie" the proposed provision of one pharmaceutical to the continued supply of another drug. The Commission considered this conduct may have been in breach of section 36 of the Act, which prohibits those with a substantial degree of power in a market from taking advantage of that power for an anti-competitive purpose. The Commission began an investigation and issued a statutory notice to AstraZeneca under section 98 of the Act requiring the company to provide certain information and documents. AstraZeneca applied for judicial review of the notice on the ground it was beyond the Commission's powers and invalid.

The conduct being investigated took place in the context of dealings between PHARMAC and AstraZeneca. This put section 53 of the New Zealand Public Health & Disability Act 2000 at issue. It provides an exemption from the restrictive trade practices sections of the Commerce Act for certain agreements PHARMAC enters into and associated conduct related to the supply of pharmaceuticals. The Supreme Court said that section 53 recognises that PHARMAC may in effect be a monopsonist (i.e. a sole or dominant purchaser) for particular pharmaceutical products and, that in order to be successful in its role, it may need to adopt practices that would clash with the prohibitions in the Commerce Act.

AstraZeneca argued its conduct was covered by section 53 and that there was no power for the Commission to issue the notice.

#### **In the High Court**

Justice Panckhurst upheld the section 98 notice in the High Court. First, he said it could not be certain at the time the notice was issued whether AstraZeneca's actions fell into the section 53 exemption. Until the Commission was in full possession of the facts, it could not form this view. Second, he said that the clear purpose of section 53 was to protect PHARMAC and not pharmaceutical suppliers. It was implicit in this finding that the court considered there may be potential to interpret section 53 in a way such that AstraZeneca could not bring itself within its ambit.

#### **To the Court of Appeal**

AstraZeneca appealed the decision. The Court of Appeal dismissed the appeal by a 2-1 majority. The majority did not favour Justice Panckhurst's first reason but considered the second could not be so easily dismissed and acknowledged that it may be legitimate to read the section 53 language down given the clear indication as to its purpose. The majority considered this question should not be decided in a factual vacuum and so the Commission should be free to advance its investigation.

However, in a lengthy dissenting judgment, Justice Fogarty said that the wording of section 53 was plain, could not be read down and that as AstraZeneca's conduct fell within that wording the Commission had no power to issue the notice.

### **Supreme Court**

AstraZeneca again appealed. Justice Blanchard gave the unanimous judgment of the Supreme Court allowing the appeal and, in essence, adopting the reasoning given by Justice Fogarty in the Court of Appeal.

The Supreme Court found that on the facts available to the Commission at the time of the issue of the notice, AstraZeneca's activity in attempting to tie the supply of one pharmaceutical to another was so plainly within the scope of the section 53 exemption as to preclude the use by the Commission of the section 98 power.

To be fair to the Commission, the current wording of this pharmaceutical exemption had not previously been subject to any judicial consideration. The fact that at least three of the nine judges who have considered this issue on its way through the courts, considered it possible that the exemption would not apply to AstraZeneca in these circumstances is evidence of the potential for ambiguity that existed on the face of the section and the facts before the Commission. With the benefit of the Supreme Court's interpretation of section 53, the Commission may well have not issued the notice.

### **Points of principle and the implications**

The decision is quite fact-specific in terms of applying section 53. However, important general principles emerge that are relevant on an ongoing basis for the Commission in its use of the section 98 power:

- The Commission's purpose in issuing a section 98 notice must be the investigation of some activity which may be unlawful under the Commerce Act. An activity which can be seen to be plainly not unlawful (here, by reason of the section 53 exemption) cannot be the subject of such a notice. Drawing on Australian case law, the court considered this was an objective test: "is the matter identified in the notice capable, after allowing for undiscovered facts, of amounting to a contravention?". This is to be assessed on the basis of the material already available to the Commission.
- The Commission does not have the power to use the notice to check whether it has the necessary power by reference to something it may discover on a "fishing expedition" pursuant to the notice. There must be a reasonable basis for the Commission to believe that there may be undiscovered facts that could give rise to a contravention.

In summary, and adopting the words of the court:

"A notice of this kind must be justified on the basis of the Commission's knowledge of the matter it is investigating (here the attempted tie) at the time of the notice. The Commission is certainly not entitled to proceed on the basis that it can issue a notice first and then have its power to do so judged retrospectively by what it might find...."

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

[Phil Taylor](#)  
Partner

[Torrin Crowther](#)  
Partner

[Simon Ladd](#)  
Partner

[David Blacktop](#)  
Senior Associate

[Jenny Stevens](#)  
Senior Associate

*Disclosure: Bell Gully acted for PHARMAC in this proceeding but the author of this article was not involved in the case.*

## Competition and consumer law

### **Court confirms New Zealand jurisdiction in overseas resident proceedings**

*In the first appellate consideration of extra-territorial jurisdiction under the Commerce Act 1986, the Court of Appeal has dismissed appeals from a High Court decision that the New Zealand courts have jurisdiction to hear proceedings against three overseas residents.*

In the first appellate consideration of extra-territorial jurisdiction under the Commerce Act 1986, the Court of Appeal has dismissed appeals from a High Court decision that the New Zealand courts have jurisdiction to hear proceedings against three overseas residents.

The case, *Harris v Commerce Commission* [2009] NZCA 84, concerned proceedings brought by the Commerce Commission seeking pecuniary penalties under the Commerce Act for alleged price-fixing and exclusionary conduct in markets for timber-preservative chemicals. Although concerned with regulatory action, the court's decision is equally applicable to private antitrust claims for damages which are brought under the same substantive legislation and procedural rules for service out of the jurisdiction (the High Court Rules).

Section 4(1) of the Act provides that, "This Act extends to the engaging in conduct outside New Zealand by any person resident or carrying on business in New Zealand to the extent that such conduct affects a market in New Zealand." The appellants contended that the legislative history and terms of section 4(1), reinforced by common law principles of restraint in the extra-territorial application of domestic laws, indicated that it specified the only circumstances in which the Act could apply to conduct occurring outside New Zealand. Since the Commission accepted that they had not engaged in conduct in New Zealand (with only one alleged exception for one appellant) and were not resident or carrying on business in New Zealand, the Act did not apply.

The court rejected this contention. It concluded that "if overseas parties agree outside New Zealand to implement a course of conduct in New Zealand which contravenes ss 27 and 30, and a person in New Zealand takes action to give effect to that agreement, the overseas parties can properly be regarded as acting in New Zealand through the New Zealand actor, certainly in circumstances where they have some authority over him or her, as is alleged here. The liability of the overseas persons does not depend on the liability of the New Zealand actors – they may be innocent agents". On that basis, the overseas residents could be regarded as having engaged in conduct in New Zealand and section 4(1) was irrelevant.

In reaching its conclusion, the court drew assistance from common law principles of territoriality in criminal conspiracy cases and was clearly influenced by the view that "legal analysis must reflect the reality of increased globalisation", which the court described as "a particularly powerful factor in a case such as the present". The court stated its belief that, consistent with the policy and scheme of the Act, entities entering into anti-competitive arrangements overseas directed at markets in New Zealand should not be able to insulate themselves from liability by operating through local entities and taking care not to hold meetings in or send communications to New Zealand.

*This article is by [Simon Ladd](#), Partner and [Natalie Small](#), Solicitor and was first published in *Global Competition Litigation Review*, July 2009.*

## Intellectual property and information technology

### **Section 92A – the latest instalment**

In July, the Ministry of Economic Development released a discussion document setting out its proposal for a reworked version of the controversial section 92A of the Copyright Act. The re-worked version attempts to address many of the criticisms of the first proposal and is a marked improvement on its predecessor. However, as senior associate Hayley Miller and law clerk Liz Blythe outline in this article on the new proposal, there are still some areas of uncertainty which need to be addressed.

# Intellectual property and information technology

## Section 92A – the latest instalment

*In July, the Ministry of Economic Development released a discussion document setting out its proposal for a reworked version of the controversial section 92A of the Copyright Act. The re-worked version attempts to address many of the criticisms of the first proposal and is a marked improvement on its predecessor. However, as senior associate Hayley Miller and law clerk Liz Blythe outline in this article on the new proposal, there are still some areas of uncertainty which need to be addressed.*

### The new proposal – a three phrase process

**Phase One:** Where a copyright owner considers, on reasonable grounds, that there has been online copyright infringement of its work(s) it may send a first infringement notice (in a prescribed form) to the internet service provider (**ISP**) involved. The ISP must forward this notice to the internet subscriber who has 30 days to respond.

If the subscriber does respond, the copyright owner must accept or reject such response and advise the subscriber of its decision.

First infringement notices remain valid for 9 months, during which time if the copyright owner detects further infringement by that subscriber the copyright owner may send a cease and desist notice through the ISP (although it is proposed that there be at least a 30 day gap between a first infringement notice and a cease and desist notice). Again, there is a 30 day response period and any response must be accepted or rejected by the copyright owner.

If no cease and desist notice is sent during the 9 month period then the ISP can destroy the record of infringement and any further action by the copyright owner must commence again with a new first infringement notice.

**Phase Two:** Where both a notice of infringement and a cease and desist notice have been issued by the copyright owner and a further infringement is detected, the copyright owner may (provided the second 30 day response period has expired) apply to the Copyright Tribunal (**Tribunal**) to obtain an order requiring the ISP to disclose the subscriber's name, contact details and other relevant information. The copyright owner must supply evidence of repeated infringement by the subscriber to the Tribunal. The information obtained must only be used by the copyright owner in relation to taking action against the subscriber.

**Phase Three:** The copyright owner can elect to register an infringement complaint with the Tribunal. The copyright owner must agree to be bound by the Tribunal's decision (subject to appeal to the High Court), pay a filing fee and provide evidence of (a) their entitlement to copyright, (b) repeat infringement by the subscriber, and (c) compliance with phase one. The subscriber will then be notified and given the opportunity to respond. The Tribunal will be convened unless the parties agree to undertake mediation. Where mediation is undertaken and is unsuccessful the Tribunal will then convene at that stage.

### The improvements

The original section 92A required an ISP to adopt and reasonably implement a policy providing for termination, in appropriate circumstances, of accounts that the ISP held with repeatedly infringing internet subscribers. The new proposal improves on this by addressing a large number of the criticisms that were voiced, through:

- providing greater certainty to the ISP, copyright owner and internet subscribers as to what the process is;
- introducing an independent third party (the Tribunal) so that it is not left for an ISP to pass judgment, which should reduce the compliance costs for ISPs and improve due process;
- requiring proof of the entitlement to copyright and the alleged infringement before sanctions are imposed;
- ensuring the internet subscriber has an opportunity to put forward their objections; and

- reducing the likelihood of fraudulent claims being brought, through the more formal process and payment of filing fees.

The original section 92A provided only for account termination (criticised as a potentially disproportionate response) whereas the latest proposal includes a range of remedies that can be awarded to a successful claimant (damages, injunctions, account of profits and fines, as well as the power to order an ISP to terminate the subscriber's internet account).

### **The remaining areas of uncertainty**

While most would agree that the recent discussion proposal is a marked improvement, the uncertainties of the first s92A which don't appear to have been addressed as yet, are the calls for:

- a specific provision addressing false accusations under this section;
- clarity around what organisations are considered an ISP for the purpose of this section. The term ISP has been given a broad definition and potentially includes organisations offering access to the internet such as internet cafes, businesses who provide internet access to employees, and those who host material on websites (such as online auction sites and social networking sites); and
- clarity as to who is considered a subscriber. No distinction is made between single home users and large business multi-users, both of which could be caught by the phrase ISP accounts.

Additionally it would be useful to address:

- what constitutes "reasonable grounds" and "reasonable evidence" for a copyright owner to be able to lay a successful complaint;
- additional funding and manpower for the Tribunal if it is to effectively execute its proposed role in the scheme, given the likelihood of a large number of complaints to it;
- the severity of offending required to warrant account termination, so that its use is not disproportionate to the actions of the subscriber; and
- whether infringers would be prevented from reconnecting where the Tribunal makes an order for termination and if so, how this would be enforced in practice.

ISPs will still have additional costs to meet as they must perform record keeping, information providing and correspondence obligations. The risk therefore remains that these costs may be passed onto its subscribers. It has also been suggested by some commentators that ISPs will unfairly have to bear the brunt of media criticism for carrying out the terminations ordered by the Tribunal and that the process may be abused by subscribers wishing to exit their broadband plans without incurring exit fees.

Finally, the workability of the legislation has been questioned as a result of most New Zealand ISPs using dynamic IP addresses which modify the addresses used by infringers regularly. "Repeat infringement" could therefore prove very difficult to prove against a subscriber whose ISP address is constantly changing.

### **The next instalment**

Notwithstanding these outstanding issues, the recent proposal is a marked improvement and, as the deadline for submissions has now closed, we will just have to wait to see whether the Minister of Commerce Simon Power's confidence that "at the end of this process we will have a law that is clear, sensible, and fair to everyone" holds true. We will keep you updated on further developments.

The section 92A consultation document can be seen at [www.med.govt.nz/section92a](http://www.med.govt.nz/section92a).

## Utilities and resources

### **Improving electricity market performance: preliminary Ministerial report**

In April 2009 the Minister of Energy and Resources appointed the Electricity Technical Advisory Group to work with the Ministry of Economic Development to review the performance of the electricity market and its governance arrangements and make recommendations on improvements. The first report which sets out the preliminary recommendations on improvements was released on 12 August 2009.

### **Market power and the power market**

In this article, senior associate David Blacktop reviews the Wolack report on the Commerce Commission's three year investigation into whether any wholesale or retail electricity companies had breached the Commerce Act.

### **ETS delay likely for energy and industrial sectors**

The Government is likely to push out the 2010 deadline for entry of the energy and industrial sectors into the New Zealand Emissions Trading Scheme.

## Utilities and resources

### **Improving electricity market performance: preliminary Ministerial report**

*In April 2009 the Minister of Energy and Resources appointed the Electricity Technical Advisory Group to work with the Ministry of Economic Development (**MED**) to review the performance of the electricity market and its governance arrangements and make recommendations on improvements. The first report which sets out the preliminary recommendations on improvements was released on 12 August 2009.*

#### **OVERVIEW**

The report identifies 29 recommendations regarding the governance, functioning and contestability of the electricity market.

In our view, these provide a sensible series of initiatives which are worthy of further debate.

The report recommends initiatives:

- To improve the management of dry years.
- To help restrain the upward pressure on generation costs.
- To improve procedures for upgrading transmission services.
- To improve retail competition and help restrain prices.
- To support these changes by improving governance of the electricity sector.

Importantly, the review was able to critically examine and reach objective views about some of the key structural issues facing the industry. These are set out in the Preliminary Conclusions section of the report and repeated below:

#### **Preliminary Conclusions of the Electricity Technical Advisory Group**

A well-functioning electricity market should provide a reliable supply of electricity at competitive prices, that is, prices which are as low as possible consistent with ensuring reliable supply over the long term.

Current electricity market arrangements are seen by many as falling short of this objective, with apparently excess price increases (especially for residential consumers) and frequent supply crises.

There appears to be some substance to these views. However, it should also be noted that:

- In the large part the increase in prices is justified because:
  - the cost of generating electricity has increased, particularly with the run down of the Maui gas field; and
  - the cost of building new capacity to meet increasing demand for electricity has risen sharply – and is continuing to rise. We need to build, every year, enough new capacity to generate 700-800 GWh/year, at a capital cost of \$400 million - \$500 million, to keep up with rising demand.
- Sufficient new generation is being built to meet increased demand and the quality of investment in generation is generally good.
- New Zealand's hydro-based system is vulnerable to dry years, and we have experienced a series of dry years over the last decade. On occasion, public conservation campaigns are required because demand savings can be lower cost than building expensive spare generating capacity to

cover every contingency.

Notwithstanding these important caveats:

- The rate at which retail prices have risen, especially for residential consumers, appears excessive when compared to the increase in the cost of new supply.
- The way in which dry years are managed can be substantially improved.
- The reliability and capacity of the transmission system can be improved.

The main causes of these problems are:

- Insufficient competition in the retail market, especially outside the main centres, combined with scope on occasion for the exercise of market power in the wholesale market.
- In dry years, there are incentives for some market participants to seek to shift increased costs to consumers through public conservation campaigns, rather than manage the risks themselves.
- There is a backlog of investment in the transmission system, which will take some years to clear.

Many also regard the governance arrangements for the sector as unsatisfactory. The Electricity Commission has too many objectives and functions and is seen to be insufficiently independent from government. There is also an unnecessary degree of overlap with the Commerce Commission in regulatory responsibilities for transmission issues.

The report has been welcomed by the Minister as offering practical solutions to many complex problems facing the electricity sector.

Submissions can be made on the report up until Wednesday, 16 September 2009.

Copies of the Report can be accessed on [MED's website](http://www.med.govt.nz/templates/MultipageDocumentTOC____41697.aspx) at [http://www.med.govt.nz/templates/MultipageDocumentTOC\\_\\_\\_\\_41697.aspx](http://www.med.govt.nz/templates/MultipageDocumentTOC____41697.aspx)

## **WISH LIST FOR ELECTRICITY MARKET REFORM**

In June, Bell Gully published a Wish List for Electricity Market Reform in which we set out our key priorities for the Ministerial Review.

A key aim of that wish list was the need to reduce New Zealand's vulnerability to dry year risk. In this context, we noted an obvious solution of building more (non-hydro) generation capacity to reduce New Zealand's reliance on our mostly hydro-generation system. Of real interest to us is that the Report has undertaken an objective economic analysis of this issue and concluded that New Zealand has sufficient generation capacity. The report concludes that mitigating dry year risk is more about managing our existing generation and transmission capacity more efficiently. Moreover, as noted above, the report concludes that it may not be economically efficient to build excess "spare" generation capacity to mitigate dry year risk compared to reducing demand for electricity in dry years through appropriate public conservation programmes. A careful balance will still need to be reached though between pure economic efficiency and what we see as the very real need to avoid any perception (both in New Zealand and internationally) that New Zealand has an ongoing risk that electricity supply to business may need to be rationed in dry years.

The other key aspect of the Report relates to recommended reforms to make the retail sector more competitive to ensure wholesale and retail customers are not being overcharged for electricity. This is discussed in more detail below.

## **ISSUES AND COMMENTARY ON RECOMMENDATIONS**

### **Transmission**

We are pleased to see that the report has confirmed as a priority the need to fix the national grid and recognises the urgent need for major ongoing investment in the national grid. The report recommends that

the current test for approving new investment in the transmission grid be amended to make it “clearer, simpler and less prescriptive, and to take account of wider competition benefits”. The report also recommends that the role of approving major grid upgrades be moved from the Electricity Commission to the Commerce Commission.

*Comment*

Consistent with our wish list for reform, we see these as important first steps in improving the speed and efficiency of the current approval processes to result in much needed investment in the transmission grid.

## Wholesale and retail competition

The shortcomings of the wholesale market identified in the report, include:

- **Short term market power:** There is currently scope for the exercise of short term market power in the spot market when the market is tight. For example, in a dry year or behind a transmission constraint, a generator may elect to hold back capacity by overpricing its offers and this can in turn impact significantly on the spot price.

*Comment*

We note that there may often be legitimate reasons to withhold water during dry years other than to exercise market power. These reasons include the value placed on that water by the generator and hedging retail exposure.

- **Hedge market:** The hedge market is not as transparent and as developed as it should be. This problem is exacerbated by the tendency for the hedge market to develop on a regional basis which reflects the applicable transmission constraints. Further, the markets as between the two islands differ because of the constraints on the HVDC system. These shortcomings mean that retailers are not incentivised to compete in some regions because of the price risk from transmission constraints at certain grid exit points.
- **Re-allocation of generation assets:** The allocation of generation assets between the three SOEs is not well balanced, for example, Meridian Energy generates almost exclusively in the South Island while Genesis Energy and Mighty River Power generate exclusively in the North Island. This reduces the scope for competitive rivalry between those generators when there are transmission constraints on the HVDC system.

In dry years there is less scope for competition between the SOEs which in turn fosters claims of certain SOEs having undue market power.

- **Demand side participation:** With the exception of utilising load reduction by major users when spot prices are high for a sustained period demand side participation in the wholesale market is not well developed.
- **Ancillary services:** The costs of ancillary services obtained by the system operator are recovered through the pricing of the electricity supplied to consumers. The report indicates there is a view that the provision of ancillary services such as instantaneous reserves and frequency keeping is not competitive.
- **Pricing:** The report concludes that prices for both domestic and commercial consumers rose quite steeply over the period since 2002.

The average retail profit margins are generally higher when compared to the eastern states of Australia and the UK. Further, there appear to be regional variations which suggest that retail margins are higher in situations where the distribution network in question involves a small number of consumers and where there are fewer retailers actively seeking to increase their customer base.

The report indicates that there is a wide range of options for improving the performance of the wholesale and retail markets. A number of options were considered but rejected. These included the vertical separation of generation and retail, wholesale and retail price caps, the mandatory offering of some hedges and the re-amalgamation of the SOEs.

The report notes that the option relating to the mandatory offering of hedges should be looked at further if the proposals to restructure the SOE generation portfolio are not proceeded with.

The measures that the report suggests for the promotion of competition in the wholesale and retail markets include:

- **Restructure SOE generation assets:** The report focussed on three options which require varying degrees of change to increase competitive tension between the three SOEs. The first option involves the creation of a new SOE and asset swaps between the existing SOEs. The second option involves the transfer of the Huntly generating plant to Solid Energy with some asset swaps between the existing SOEs. Both these options have been rejected by the Government (at the time it released the Report) on the basis of cost and timeliness which leaves the third option involving the transfer of the Huntly generating plant (e3p and p40) to Meridian Energy and the transfer of the Manapouri hydro station and the White Hill wind farm to Genesis Energy.

The third option is intended to reduce Meridian's dominance in the South Island and achieve a better spread of flexible thermal and hydro resources. This spread is also intended to create competitive tension in the context of the reaction of generators to a dry year. However, the Government has stated that it will need to be convinced that this option is worth pursuing.

*Comment*

It will be interesting to see if the third option will get further traction. As noted, we understand the Minister remains to be convinced and has questioned whether the objectives behind the third option asset swap could be achieved contractually rather than going to the extent of a change of ownership. The reorganisation of assets will be complex and may create more problems than it solves because of the difficulty in "fitting" some of the assets into existing asset portfolios. We think that some form of contractual arrangement is most likely and is best.

Some of the issues relating to lack of competition will also be assisted by fixing the transmission grid to remove the constraints in the HVDC link that occurred during last winter between the North and South Islands. This effectively meant that New Zealand had two independent electricity systems for critical periods over a dry winter – exacerbating the supply/demand imbalance.

- **Transmission hedges**

One of the reasons retail competition is limited in some regions is the price risk that is faced by the retailers due to transmission constraints affecting those regions. The availability of some form of transmission hedging mechanism would allow wholesale purchasers to manage the transmission risks.

Transmission hedges were initially proposed in the mid 1990s, however, the mechanism for hedging transmission risk was never implemented. One of the reasons for the delay was the need to upgrade Transpower's market systems (IT and software) used to support the wholesale market.

The report notes that while there is some debate about the nature of the transmission hedging mechanism, it recommends that such a mechanism be put in place as a matter of priority to facilitate greater retail competition in regions where there are transmission constraints.

The report suggests that transparency of the hedge market will be improved if the SOE generators are required to disclose their individual risk positions (as the publicly listed generator/retailers are required to do). The rationale being that this would enable the independent generators (such as TrustPower, Contact Energy, Todd Energy and the line companies) to identify new investment opportunities and it would also impose a risk management discipline on the SOE boards.

- **Demand side participation**

An improvement in demand side participation would widen the number of options available to address contingent events such as the outage of a generator. Further, effective demand side participation would act as a counterweight to the role of electricity generators in determining the spot price

especially in times when the market is under stress. It may also enable the deferment of supply side infrastructure.

However, to have an effective demand side response the market needs to be aware of the real time price of the electricity in advance rather than relying on forecast spot prices.

Again, one of the reasons advanced for not being able to develop effective demand side participation has been the inability of Transpower's market reporting systems to cater for the capturing and dissemination of this information on a real time basis.

*Comment*

Given that Transpower has now completed the upgrade of its market systems it should be possible to design and implement the necessary information exchange systems to facilitate an effective demand side market.

- ***Retailing by local lines companies***

Currently local lines companies are only permitted to retail electricity in their network area from generation which they have built. The report notes that while many lines companies are unlikely to be keen on getting back into retailing, there may be a case for lines companies to become involved in retailing in remote areas where there is an absence of competition. The report advocates the relaxation of the current restrictions on line companies retailing electricity but restricts this to a stated maximum and precludes line companies from being able to acquire retail customers rather than growing their retail base organically.

*Comment*

As stated in our wish list for reform we question whether it would be better to remove all restrictions on electricity line companies being able to enter the retail market, so long as their line and retail/ generation businesses are operated on a transparent and stand alone basis. We think it better to accept that there is no regulatory policy basis any more for the separation requirement (in that this is now met by specific regulation of line network businesses) and letting market forces decide. This is because retailing electricity is a low margin activity and the lines companies have disposed of their systems for pricing and billing and are unlikely to have adequate generation portfolios to support growing a customer base. Accordingly, it seems to us that there will be a cost barrier to entry into the retail market unless a lines company can quickly achieve size and scale of operations. The ability of line companies to enter the retail market will also be assisted by the development of a more liquid hedge market such that line companies can effectively have "virtual" generation capacity to provide a back up hedge of their retail operations.

The issue may also be addressed by lines companies actively encouraging the development of distributed/embedded generation by themselves or in partnership with third parties in the affected area. This approach may enable relevant lines companies to provide electricity from an "alternative source" as contemplated by the Electricity (Continuance of Supply) Amendment Bill.

- ***Standardised line tariffs***

The diversity of the tariff structures applicable to the various distribution networks throughout New Zealand are possibly a factor which discourages new retailers from extending their retail activities to a wider range of smaller electricity distribution networks.

The Report recommends that the work being undertaken to standardise tariffs be progressed.

- ***Smart metering***

The Report notes that smart metering and tariffs which encourage consumers to better manage their electricity consumption have a potential to significantly improve energy efficiency and load management with consequent cost reductions.

The report recommends that standards and guidelines on smart meters make provision for the equipment to have energy efficiency capability, allow open access communications and readily permit switching by customers. Coupled with the smart metering capability, consumers should be offered

pricing which incentivises them to manage their electricity consumption, through load shifting and conservation.

*Comment*

Smart tariffs and smart meters have the potential to improve energy efficiency and load management by giving the individual consumer the ability to directly influence the amount of electricity used and the total price it pays. They also allow electricity retailers to provide much quicker price signals to allow consumers to manage their electricity costs.

- **Market data**

The New Zealand market currently releases data about the wholesale market some two weeks after the relevant transaction. The report recommends adopting the Australian model which provides for all market data to be released in an easily readable format the following day.

- **Customer switching**

The report suggests that greater customer activism would be very beneficial. If customers become more active in shopping around this will force the retailers to become more competitive.

To facilitate this the Report suggests improving the Powerswitch website to provide up to date information and shortening the time frame in which retailers are required to switch customers with smart meters to 3 days instead of 23.

## **Security of supply and dry years**

The report concludes that overall sufficient investment is taking place in generation, however, the market is still vulnerable to dry years because of the reliance on hydro generation which in dry years is effectively "run of river" with very little storage capacity. Building sufficient thermal generation to totally cover dry year risk is uneconomic so the least cost approach is to use temporary conservation campaigns to reduce demand.

The report has looked at the responses by the electricity market and the Government to recent dry years and has identified the following issues and suggests ways of addressing them.

- **Responsible parties**

It is essential that everyone understands who is responsible for dealing with the management of security of supply issues and the initiation and management conservation campaigns.

The report recommends that an Electricity Market Authority (EMA) be established with responsibility for developing the rules dealing with security of supply and that the system operator have responsibility for emergency management. A Security and Reliability Council will monitor the system operator's performance and report to the EMA. The Minister will be responsible for triggering any public conservation campaign.

- **Shifting risk**

The Report notes that there is a perception that generators and large commercial consumers attempt to shift the risk and attendant costs for dry years to the end use consumers by seeking the use of the reserve generation capacity (Whirinaki) and national conservation programmes. The costs incurred in using reserve generation and in conducting the conservation programmes are ultimately recovered from the end use consumer through the price of electricity.

To address this concern about "shifting risk" the report suggests requiring retailers to pay a sum (i.e., \$10 per week with a mechanism to increase it in proportion to the national savings achieved) to each customer by way of a credit during any electricity conservation programme. The rationale being that the imposition of such a payment when aggregated across all the retailer's customers may encourage the retailer to address the shortfall in electricity by hedging or by investing in new or improved generation.

*Comment*

This proposal which compensates consumers affected by conservation campaigns is likely to increase costs. In practical terms the retailers would compare the cost of the compensation with the cost of the options of arranging hedging or investing in new or improved generation. These options would only be selected if they were considered cheaper than making the compensation payments. Further, the imposition of a compensation payment may be at odds with the desire to reduce the upward pressure on costs.

Mandatory tariff structures (smart tariffs) which adjust according to the electricity being saved over a sustained period may be an alternative. This would encourage individual consumers who are in a position to do so to actually provide meaningful demand side management during the security risk period.

- ***Reserve energy scheme - Whirinaki***

The reserve energy scheme which involves the use of the Whirinaki power station distorts the market and in practical terms is limited by the transmission constraints in the Hawkes Bay area. The operating costs of the scheme are intended to be recovered by the spot revenue and the fixed costs are recovered by a levy.

The reserve energy scheme effectively places an artificial cap on the spot price of electricity at the time of a shortage. In doing so it reduces the incentive for market participants to manage their supply risks.

The Report suggests that the reserve energy scheme be dispensed with and the Whirinaki generation plant disposed of (transferred to an SOE or sold). Alternatively, if the Government wants to retain the reserve energy mechanism then the generation plant should be sold or transferred to an SOE and its "standing costs" allocated to the parties that directly benefit from it (i.e., the parties who are exposed to spot prices) by way of a surcharge on the spot prices during the period of its operation.

*Comment*

As noted in our wish list for reform, it would also be helpful if a long-term gas sale agreement could be part of the sale/transfer package as this will have a key bearing on the functioning and utility of any restructured Whirinaki going forward.

- ***Floor on spot prices***

To remove the incentive for generators and retailers to push for public conservation campaigns which shift costs onto consumers in general and in order to encourage better management of dry year risk the Report suggests the imposition of a floor on spot prices when a public conservation campaign and enforced power cuts are triggered by the Government.

The Report notes that the imposition of a floor price may encourage hydro generators to contract with owners of thermal plant to cover dry year risk. It may also provide an incentive to develop back up generation such as "peaker plant".

- ***Dispatch of demand response***

An additional tool for assisting in the management of dry year risk is the suggestion that the System Operator should be permitted to include demand side response offers in the "offer stack" which can be dispatched in the same way as generation offers.

- ***Disclosure of SOE risk***

Publicly listed generator retailers are required to disclose material information about their risk positions to the market place, however, SOEs are not subject to the same discipline.

The Report recommends that in the interests of transparency and a level playing field, the SOEs should be required to disclose such information on an ongoing basis.

- **Reserve water**

Some hydro generation station catchments have the ability to access water for generation but restrictions are placed on accessing this water by the relevant resource consents. In 1992 special legislation was enacted which overrode the resource consents to allow water in Lake Pukaki to be accessed. The Report notes that the Government seriously considered this type of legislation in 2008.

The Report suggests that the Government explore the possibility of clarifying when and how this reserve water could be used. It suggests capping the revenue of the generator using this type of water to reduce the incentive to rely on it.

## Governance

The Report is not clear as to the priority afforded to the issue of restructuring the governance of the electricity sector (it appears as the last set of recommendations). However, it seems fundamental to get the governance restructuring in place as part of changing and allocating new and existing regulatory and other responsibilities.

The criticisms of the current governance structure, some of which are highlighted in the Report, include the following:

- **Political risk:** There is potential for political interference in the decisions of the Electricity Commission (**EC**) because the EC is not independent of the Government, it is effectively an agent of the Minister. In addition to its role as regulator, the EC is expected to implement the Government's policies as they apply to the electricity industry. The potential delays and/or costs arising from this political risk are a disincentive for investors in the electricity market and infrastructure.
- **Two entities:** The regulation of investment in the transmission sector involves two entities, the EC and the Commerce Commission. For example, the EC currently approves investments in the national grid while the Commerce Commission oversees the expenditure which Transpower New Zealand Limited (**Transpower**, as grid owner) incurs in maintaining the grid. This issue of regulatory overlap has already given rise to confusion about whether the Commerce Commission is required to re-litigate what the EC has already decided. An attempt has already been made to address this confusion between the roles of the two Commissions by way of a memorandum of understanding.
- **Multitude of functions and duplication:** There is a perception that the EC has too many functions and expectations placed on it by the Government and by industry participants. It is required to perform the role of regulator (i.e., monitoring and enforcing the Electricity Governance Rules 2003 (**EGRs**)) as well as developing the electricity market in accordance with the Government Policy Statement (**GPS**) for the electricity industry.

The EC has obligations to perform under the EGRs for example, under Part F dealing with investments in transmission. In this context there seems to be duplication in some work streams with the work being undertaken by other agencies such as the Commerce Commission. Another work area of the EC where there is the perception of duplication is electricity conservation and energy efficiency which is similar to the work undertaken by the Energy Efficiency and Conservation Authority (**EECA**).

Taken together, these criticisms suggest that the overall governance structure for the electricity industry is confusing and is not currently promoting the timely resolution of issues which in turn has cost implications for participants in the electricity market and ultimately end use consumers. To address these criticisms the Report proposes:

- **Electricity Market Authority:** Replacing the EC with an Electricity Market Authority (**EMA**). The EMA will be an independent crown entity under the Crown Entities Act 2004 with a majority of the members being nominated by business and consumer groups and by electricity industry participants.

The EMA's sole objective will be to ensure the efficiency of the electricity market for the long term benefit of consumers. Its functions would be to develop and approve market rules (it will take over responsibility for the EGRs) and to monitor compliance with those rules. Other public policy objectives related to the electricity industry would be dealt with by institutions such as the Commerce Commission, EECA and the MED.

*Comment*

In practical terms, the EMA will take over the responsibility which the EC currently performs as the regulator of the electricity industry in overseeing the application and development of the EGRs.

The issue of changes to existing EGRs or how new EGRs are to be handled will need to be addressed. The Report suggests that retaining the involvement of the Minister may provide checks and balances in the process of changing or making the EGRs. However, on balance the Report suggests that the EMA should be empowered to make rules covering technical matters involving market operations and would have an ability to recommend non-technical rule changes to the Minister.

The issue of how the GPS for the electricity industry is to be implemented will need to be addressed. Will the EMA be required to have regard to the GPS in a similar manner to the economic policy statements provided to the Commerce Commission?

The EMA will need to have a more proactive and timely approach to investigating and making decisions on complaints about breaches of the EGRs. The current processes for investigating and making decisions on complaints takes too long, the processes need refining so that complaints are quickly investigated and resolved.

- **Major grid upgrades:** The process for the approval of major upgrades of the national grid is to be made the responsibility of the Commerce Commission as part of its existing regulatory role for Transpower under Part 4 of the Commerce Act. The reliability and service standards, transmission pricing methodology and grid investment test would still be set by the EMA. The Commerce Commission would carry out its assessment of any investment proposal in the light of these rules.

*Comment*

We agree that having the Commerce Commission review the grid investment test makes sense as part of the regulatory role carried out in relation to Transpower. It will be important for the Commerce Commission to be appropriately resourced to carry out these additional functions.

- **Functions to system operator:** A number of functions which are currently undertaken by the EC are to be transferred to the System Operator. These functions include information about and forecasts on security of supply, emergency management, the contracting for market operations (such as clearance and reconciliation) and the operation of any reserve energy facility.

*Comment*

In our wish list for reform we identified that a fundamental guiding factor for reform initiatives is to simplify what is a very complex industry. Having reviewed the Report, we appreciate that in breaking up the EC's existing regulatory functions and having new and other governance structures to deal with these there is a natural trade off with simplicity. We agree that this can not really be avoided in this case. Even though the Report recommends more governance bodies are created this added layer of complexity should be off set by clarity of role. One question we raised in our wish list for reform which we think remains valid is to question whether it would be better for the (new) EMA to take the lead on emergency management of electricity in dry years. It would seem better to us to have a body independent of Transpower undertaking this role given Transpower's other role as owner / operator of the national grid and ongoing transmission constraints. It could also mean that there would not be a need for a separate Security and Reliability Council (referred to below) which would remove one additional layer of governance from the industry.

If the transfer of functions to the System Operator or the EMA proceeds it will be necessary to ensure that the relevant party has adequate resources and IT systems and software in place to provide the required level of information and forecasting from the outset

- **Security and reliability council:** The EMA is to set up and service a Security and Reliability Council comprised of senior persons from the electricity market who are to monitor and provide advice on the System Operator's performance of its functions and on security of supply issues generally.

*Comment*

The Council could play a useful monitoring and advisory function however, the Council's role will need to be clarified. Is it to be advisory only or will it have some standing which will enable it to make a complaint to the EMA about a breach of the EGRs by the System Operator? Further, what standing (if any) will its recommendations for example, to improve systems or take certain action have?

- **MED and EECA:** The functions relating to consumer equity type issues (which presumably would, for example, include administering the guidelines for vulnerable consumers) are to be transferred to the MED.

The functions of the EC relating to energy conservation and efficiency are to be transferred to the EECA.

*Comment*

This makes sense to us.

## **Other reviews**

The Report notes that other Government reviews and policy development projects are underway in relation to climate change, the Resource Management Act, gas exploration, geothermal reserves, model retail pricing, Transpower's pricing methodology and mandatory guidelines for smart metering. The Report recommends that these studies and policy projects take account of the recommendations arising out of the Report in the context of the electricity industry.

### **For further information please contact:**

[Andrew Beatson](#)

Partner

[Andrew Brown](#)

Partner

[Garry Downs](#)

Partner

[Chris Gordon](#)

Partner

[Chris Hay](#)

Senior Associate

## Utilities and resources

### Market power and the power market

*In this article, senior associate David Blacktop reviews the Wolack report on the Commerce Commission's three year investigation into whether any wholesale or retail electricity companies had breached the Commerce Act.*

In May the Commerce Commission finished its three year investigation into whether any wholesale or retail electricity companies had breached the Commerce Act. The investigation evolved from complaints about high electricity prices, large company profits, a perceived low level of competitive activity and allegations of anti-competitive conduct.

The Commission's analysis (performed by Professor Wolak of Stanford University) suggested that "wholesale prices charged over the period 2001 to mid-2007 resulted in an extra \$4.3 billion in earnings to all generators over those that they would have earned under competitive conditions". A number of highly respected commentators have levelled significant criticism at the basis on which this figure was assessed but a detailed analysis of that issue is beyond the scope of this article. However, even putting aside those criticisms, the Commission concluded that there was no evidence of conduct that breached the Commerce Act.

To the casual observer these conclusions must appear completely contradictory. How can the Commission conclude that generators have earned an extra \$4 billion but not have acted anti-competitively? Isn't the Commerce Act there to prevent these sort of prices being charged?

The answer to that is yes..... and no.

#### **The role of the Commerce Act**

The Commerce Act's underlying rationale is to promote New Zealand's economic interests and economic efficiency and is premised on the belief that competition is the best way to achieve this. However, the distinction between outcome (economic efficiency) and the process to achieve it is important.

The Commerce Act itself recognises this distinction in its three distinct operative parts:

- Part II, which prohibits "restrictive trade practices" e.g. section 36 which prohibits a firm from taking advantage of substantial market power for anti-competitive purposes and section 27 and 30 which, among other things, prohibits firms entering into or giving effect to collusive arrangements that have an anti-competitive purpose or effect.
- Part III which contains New Zealand's merger laws; and
- Part IV which contains regulatory control provisions.
- Parts II and III focus on protecting the process for ensuring there is true competition. Part IV is designed as a back-stop so that if competition does not deliver the desired outcome, the desired outcome can be imposed on a market via regulation.

The Commission's investigation was under Part II and asked: was the cause of the "extra profits" collusive conduct between firms, or individual firms with substantial market power seeking to prevent competition from occurring?

#### **The role of profits in markets**

Importantly, Part II does not prohibit firms earning a profit (sometimes called an economic rent). Profits play an important role in either providing the right signals for people to enter markets or the incentives for people to develop products which they hope will earn them above normal returns. The importance of profit in driving desirable investment in product innovation is the reason why patent protections exist for example.

Part II and Part III of the Commerce Act seek to ensure that there is nothing in place that would prevent or hinder a new firm entering a market or expanding in a market in an effort to earn some of the profits earned by existing participants. There may be a number of reasons why such a reduction in profits cannot occur:

- It might be because firms are engaging in restrictive trade practices, e.g., existing firms agree to deter new entry or maintain profits at a certain level by sharing markets or not competing as strongly as they otherwise would. This type of conduct is a Part II issue.
- Equally, entry and expansion may be hindered by matters entirely independent of the market participants, e.g., government policy decisions or the existence of an industry with natural monopoly characteristics. This could be a Part IV issue or alternatively, could require a different policy decision to alter the characteristics of the market as happened for example with the forced unbundling of Telecom's local loop.

Therefore sustainable profits could be a symptom of a Part II breach; however, they are not and cannot be conclusive of a Part II problem.

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

Essentially, the Commission's concluded that in a normal market the alleged "4.3 billion" in extra profits should have attracted new entry or caused the existing firms to expand so as to compete for these profits. But, the Commission also had to accept that the fact this did not occur was not the result of a Part II issue. It found no agreement between generators to pull their competitive punches. Nor had any of them acted to deter new entry. They had simply acted as any profit maximising firm would in the same circumstances.

Of course, one should not be lulled into believing that the Commission is convinced there isn't a problem with the effectiveness of Part II itself and the difficulty it faces in proving breaches of this Part in this and other cases will no doubt inform its current review of the scope of section 36.

Rather, the Commission's conclusions suggest the ability for the power companies to earn the alleged extra profits sustainably was due to the peculiar nature of electricity as a commodity, the difficulties in gaining new entry due to Resource Management Act constraints etc, and various issues associated with the way the market was designed by policy makers.

Dealing with those issues is a matter for policy makers not the Commerce Act. Indeed, when it granted authorisation for the rules which now form the basis of the market the Commission rightly said "The Commission does not have the mandate, nor the expertise, to be the market designer".

Questions of how market design can be improved and/or barriers to entry and expansion can be lowered and what weight should be given to Professor Wolak's analysis must now be grappled with by others and to that end, the Government's taskforce to review the operation of the electricity markets will be critical.

*This article was first published in NZLawyer, 26 June 2009.*

## Utilities and resources

### ETS delay likely for energy and industrial sectors

*The Government is likely to push out the 2010 deadline for entry of the energy and industrial sectors into the New Zealand Emissions Trading Scheme.*

This latest development follows on the heels of the Climate Change Response (Emissions Trading Forestry Sector) Amendment Act, which was passed on 30 June and delays several of pre-1990 foresters' deadlines and obligations under the New Zealand Emissions Trading Scheme (ETS).

Speaking to the Local Government and Environment Select Committee in June, Climate Change Minister Nick Smith was reported as stating that the current timetable for the energy and industrial sectors (which would see those sectors entering the ETS from 1 January 2010) was "always unachievable, even without a select committee review" and that "there is going to have to be some modification".

The allocation plan for the energy and industrial sectors is yet to be finalised, and the Minister reportedly stated that it would be untenable for those sectors to be introduced into the ETS when the allocation details are unknown.

While no official announcement on the treatment of the energy and industrial sectors is likely until the ETS review committee has reported back (which is expected to be in August), the Minister's comments leave little doubt that the planned 1 January 2010 entry of these sectors into the ETS will be delayed.

While the delay may be effected through provisions in the substantive Amendment Act likely to follow from the ETS review committee's report, it could be that a specific piece of expedited legislation (similar to the forestry amendment Act) is used to provide certainty to the energy and industrial sectors in the short term around the date their compliance obligations come into effect.

The National Party will be hoping to have ACT's support in getting any such legislation through the House. If ACT's support is not forthcoming, it would need to seek support from the Greens, the Maori Party, or even Labour – with whom it has been in talks in recent weeks to seek compromise on an amended ETS.

#### **The effect of delayed entry**

Any delay to the entry of the energy and industrial sectors would be good news for firms in those sectors who would otherwise have faced uncertainty over the impact of the ETS on their costs of production (given that no allocation plan has been released). However, it would not be welcomed by foresters (and other prospective vendors of emission units), who would have expected energy and industrial sector participants to be strong early purchasers of their emission units and who may now face a decrease in demand at least in the short term.

#### **Further draft regulations**

A second draft of regulations setting out the methods for participants to monitor and calculate their emissions for energy and industrial activities has recently been consulted on. The latest draft is an update to regulations released in October 2008 and incorporates amendments made following consultation on the earlier draft. The regulations do not deal with or affect the timing of the entry into the ETS of the energy and industrial sectors.

Further draft regulations released at the same time provide a process to enable certain participants in the energy and industrial and liquid fossil fuels sectors to apply for approval to use a unique emissions factor when calculating emissions. Both these sets of regulations are due to be finalised by 1 October 2009.

More detail on the regulations can be found at the Government's Climate Change Information website: [www.climatechange.govt.nz](http://www.climatechange.govt.nz)

*This article was written by [Simon Watt](#), Partner and [Kate Radka](#), Senior Associate and [Andrew Dentice](#) and was first published on the Bell Gully website (15 July 2009).*

## Bell Gully News

### [Sir Peter Blake leadership legacy recognises inspiring Bell Gully partner](#)

Bell Gully partner Rachel Paris has been named as the youngest recipient in this year's prestigious Sir Peter Blake Leadership Awards.

### [New tax and litigation lawyers for Bell Gully](#)

Bell Gully has made four new appointments to its legal team in Auckland, including two new senior associates.

## Useful web links

### New Zealand Government

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

### New Zealand regulatory agencies and organisations

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

### New Zealand commercial sites

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

### Australian sites

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

### International sites

- [NASDAQUH](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]