Commercial Quarterly

SPRING 2009

Welcome to the Spring 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:

- The changing face of the NZ ETS;
- Establishing directors' personal liability in liquidation cases;
- Progress made on the implementation of the new financial advisers' regime;
- Increased monetary threshold for share purchase plans;
- Supreme Court confirms a nominee can enforce contractual obligations;
- Guidance on the 'failing firm' argument for mergers and acquisitions;
- Madrid is coming to New Zealand; and
- Cartels, leniency, markers and double-dip dobbing.

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

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Commercial business law

Supreme Court confirms a nominee can enforce contractual obligations
In this article, solicitor Jenny Roest discusses a recent Supreme Court decision which confirms that the description of a purchaser in a sale and purchase agreement as “X and/or nominee” is sufficient identification for the nominee to take the benefit of the agreement and enforce it against the vendor under the Contracts (Privity) Act 1982.

Employees held to account over setting up in competition
In this article, partner Rob Towner and senior legal professional Deborah Doak discuss a recent Employment Court decision which found former employees of an earthmoving specialist liable for breaches of their duties of fidelity and trust and confidence for setting up a competing business. The article also provides some practical tips on steps employers can take to safeguard their business interests against such events.

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Supreme Court confirms a nominee can enforce contractual obligations

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Often, a sale and purchase agreement will state the purchaser as being "X and or nominee". This enables a different entity to complete the purchase and is particularly useful where, for example, at the time the parties enter into the agreement there is some doubt as to which company in the purchaser's group will be nominated as the purchaser. It is also common to make use of a nominee where a family trust is to be substituted for the purchaser at completion or where the company or trust is not in existence at the time of entering the sale and purchase agreement.

In such cases, the question arises as to whether the nominee (who is not a party to the agreement) is entitled to enforce the agreement. The law in New Zealand on this point has recently been settled with the Supreme Court[1] refusing to grant leave to appeal the Court of Appeal's decision in *Laidlaw and Anor v Parsonage and Anor*[2] . This decision confirmed that a contract specifying "X and or nominee" as the purchaser is sufficient to bring the nominee within section 4 of the Contracts (Privity) Act 1982 (the Act), enabling the nominee to enforce the contract under section 8 of the Act.

The facts

The Laidlaws, as the vendors, had entered into a sale and purchase agreement with Mr Parsonage "and-or nominee" for the sale of a residential property. Mr Parsonage and Mr Goulding, as trustees of a family trust, became the nominee under the agreement. The Laidlaws' agent was told that a family trust would be purchasing the property, with solicitor to solicitor correspondence referring to the purchaser as either the trust or the trustees. It was suggested that the description of the purchaser in the sale and purchase agreement was used to avoid having to obtain Mr Goulding's signature on the offers and counter-offers leading to the final agreement.

Shortly after Mr Parsonage moved into the property, it was discovered that the property leaked. The trustees sued the Laidlaws with one of the claims based on a warranty contained in the sale and purchase agreement. Consequently, one of the issues before the courts was whether the trustees, as the nominee under the sale and purchase agreement, were entitled to enforce the agreement.

The decision

Under section 4 of the Act, where a promise contained in an agreement benefits a person who is not a party to the agreement, the person making the promise must still deliver on it. Section 4, however, requires the beneficiary to be designated by name, description, or reference to a class (whether or not the beneficiary exists at the time of contracting). The purpose of this requirement is to identify the promisee with certainty[3]. The Supreme Court commented that designation by description requires no more than a sufficient identification of the person who may take the benefit. Given that once nominated the nominee is identifiable with certainty, the nominee will be a person designated by description for the purposes of section 4. The Supreme Court noted that in its view:

"There is no good reason why that person should not be identified by the nomination of the purchaser. Identification by a third party or by the occurrence independently of an event or by some other particular means is not required by [section 4]."

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[1] [2009] NZSC 98

[2] [2009] NZCA 291

[3] *Rattrays Wholesale Ltd v Meredyth-Young & a'Court Ltd* [1997] 2 NZLR 363; *Laidlaw and Anor v Parsonage and Anor* [2009] NZCA 291

As noted above, it also does not matter for the purposes of section 4 that the person is not in existence at the time that the sale and purchase agreement is executed.

The proviso to section 4 of the Act which states that the promise must be intended to create, in respect of the benefit, an obligation enforceable by the beneficiary is also met by the use of the term "X and or nominee" as the purchasing party. The Court of Appeal considered that the inclusion of the nominee, when defining the purchaser, was designed to provide the nominee with a right to enforce obligations under the agreement and, therefore, that the requirements of the proviso were met.

Enforcement of the contract by a nominee is covered by section 8 of the Act which provides for the beneficiary of a promise to enforce the contract "as if he were a party to the ... contract, and relief in respect of the promise, including relief by way of damages, specific performance, or injunction, [is not to be] refused on the ground that the beneficiary is not a party to the ... contract in which the promise is contained or that, as against the promisor, the beneficiary is a volunteer".

Comment

The result of the decision is that a nominee, designated by the definition of a purchaser as "X and or nominee", will be able to enforce the contract against the vendor under the provisions of the Contracts (Privity) Act. It should be noted however that this decision does not relieve the "named" purchaser from its obligations under the contract. The vendor has the protection of the continuing liability of the named purchaser if the nominee proves unwilling to complete.

Employees held to account over setting up in competition

In this article, partner Rob Towner and senior legal professional Deborah Doak discuss a recent Employment Court decision which found former employees of an earthmoving specialist liable for breaches of their duties of fidelity and trust and confidence for setting up a competing business. The article also provides some practical tips on steps employers can take to safeguard their business interests against such events.

The rules around staff poaching customers or information from their employers to then set up in competition are clear.

Employees are bound by the implied duties of fidelity, good faith and trust and confidence from competing with their employers or soliciting customers for personal gain or to assist some other competing activity. Even if a customer approaches a staff member in a personal capacity with an offer of work, the duty of fidelity obliges the employee to reject the offer and report it to the employer.

These principles have been affirmed by the Employment Court in a recent decision in favour of the employer. Three former senior employees of an earthmoving specialist were found liable for breaches of their duties of fidelity and trust and confidence.

The court focused on these implied duties because the employees did not have written employment agreements. It said that top management should not be allowed to profit from business opportunities that became known to them during their employment.

Employees' breaches of implied duties

In this case the employees breached the obligations of fidelity and trust and confidence by:

- acting in concert to both secure work from customers of the employer and solicit the employer's staff (highly skilled plant operators) for their own entity which they had set up in competition with the employer;
- failing to disclose to the employer knowledge of their efforts to solicit work for the new company and solicit other employees; and
- removing and misusing confidential information, including obtaining customer lists and using pricing information and quotations provided to clients to undercut the employer for the benefit of the new entity.

The actions of the staff while employed enabled the competing business to begin trading immediately after their employment ended, which it did with success. The employees effectively stockpiled work opportunities for the new company. One employee deleted information about forward work orders to deprive the employer of the work and used that information to assist the new business. As a result, the employer's business suffered a significant drop in turnover.

Interestingly, the primary source of evidence of the employees' wrongdoing was a credit memorandum prepared for a finance company in support of a loan application. The memorandum pre-dated termination of the employees' employment and described certain steps the employees had taken to establish the competing entity, including securing some of the employer's customers and staff.

Duty to disclose knowledge of misconduct

The court said that in certain circumstances the duty of fidelity and good faith required an employee to inform the employer of misconduct they knew about, including their own. A senior employee having observed or committed actions potentially harmful to the employer, including soliciting of customers and/or staff, was required to report that conduct to the employer. This also applied to conduct performed at that employee's instigation. Accordingly, the employees were obliged to disclose to the employer their knowledge of their own and each others' efforts to solicit customers and staff.

However, the court was not persuaded that an employee was required to disclose either a simple intention to leave and compete or lawful acts taken in preparation where there was no actual competition with or damage to the employer during employment.

Preparatory steps not breach of fidelity

In this case preparatory steps taken by the employees during employment to establish the new competing entity (incorporation, arranging financing and purchasing/hiring plant and equipment) did not amount to a breach of fidelity or trust and confidence in the absence of evidence that these steps themselves undermined the employer.

No right to leave job before notice expires

The most senior of the employees had given three months' notice when he resigned, which the company accepted. However, he abandoned his job after only working three weeks or so of the notice period.

The court said that in the absence of consent from the other side or good cause, neither party was entitled to terminate the employment earlier than the expiry of the notice period. That meant the employee was liable for any damages suffered by the employer as a consequence of not working out his notice period.

Damages were not determined by the court, but would be subject to the employer's duty to mitigate its loss.

As the employee did not have a written employment agreement, the court did not have to consider the issue of any express clause for payment in lieu of notice (PILON). However, where there is an applicable PILON clause, an employer can in certain circumstances bring forward the termination date and pay the employee in lieu of the remainder of the notice period.

Practical tips

Prudent employers will want to ensure that employment agreements contain suitably drafted provisions for confidentiality, PILON and garden leave, which allows the employer to require an employee not to perform all or some of their duties or remain at home during all or part of the notice period. Also important to safeguard the business is an express obligation for the return of company property and information on the employer's demand.

Legitimate proprietary business interests such as confidential information, customer relationships and goodwill can be protected in the form of post termination restraints.

Restraints not to compete with the employer or solicit customers, employees and/or suppliers of the employer after leaving will be enforceable only if they are no wider in scope than is necessary to protect the former employer's business. Careful consideration should be given to whether there is a need for restraints and if so they should be specifically tailored to the employee in question and the nature of the employee's role.

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Company law

Establishing directors' personal liability in liquidation cases

When a company is close to insolvency (or insolvent), decisions taken, or not taken, by the company's directors at the time can result in the directors being personally liable for contributions to the company's debts in liquidation. Two recent cases provide guidance on the courts' approach to findings of liability and the determination of the amount of a director's liability in such situations.

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The law

In the course of a company's liquidation, the court is empowered to make orders (under section 301 of the Companies Act 1993) where directors have been found to be in breach of certain duties (or other matters referred to in section 301) in relation to the company. The orders include providing for the director (or directors) to:

- contribute such sum to the assets of the company by way of compensation as the court thinks just; or, where the application is made by a creditor,
- pay or transfer money or property or any part of it with interest at a rate the court thinks just to the creditor.

In most cases claims for contribution under section 301 are based on the breach of one or more of a director's statutory duties under the Companies Act (the Act). In addition to the general duties which require that a director act in good faith and in the best interests of the company (section 131), and exercise the care, diligence and skill that a reasonable director would exercise (section 137), there are two duties which are often the focus of section 301 claims. These are the reckless trading and obligation provisions in sections 135 and 136 of the Act which require a director:

- not to agree to, cause or allow the business of the company to operate in a manner likely to create a substantial risk of serious loss to the company's creditors (section 135); and
- not to agree to the company incurring an obligation unless the director believes at that time on reasonable grounds that the company will be able to perform the obligation when it is required to do so (section 136).

Peace and Glory Society Limited (in Liquidation) and anor v Stefano Samsa

In a recent case, *Peace and Glory Society Limited (in Liquidation) and anor v Stefano Samsa*[4], the Court of Appeal affirmed that the appropriate approach to a claim under section 301 should be in two stages. First the court should consider whether the director was in breach of any of the duties he owed to the company and second, the court should, in its discretion, determine whether and to what extent a director should be required to contribute to the assets of the company. The second stage allows the court to inquire into the overall justice of an order under section 301 relative to the breach (or breaches), consequent losses and the director's level of culpability.

The facts

The case involved a claim by the liquidators of Peace and Glory Society Limited (the company) against the company's sole director (who was also the only shareholder of the company). The company had been established by the director for use as a vehicle to carry out a small property development business. In 2000, the company acquired a residential property which was on land capable of being subdivided. The purchase of the property was financed by a bank loan (secured by a first mortgage) and a series of loans from the director's mother (which were eventually secured by a second mortgage). The mother's loans were also used to develop the property.

The plan was to develop the property in two stages. The first stage involved the renovation of the existing property on the land for resale and the second stage was to subdivide the section and build on the

[4] [2009] NZCA 396

subdivided site for resale. Since the property had been acquired for development the company was entitled to and had received a GST refund for the GST paid on the purchase of the property which was repayable on the resale of the property.

Unfortunately for the director, the first stage of the development took longer and was more expensive than expected. By late 2003 he could not source the required funding to complete the project and the valuation of the property showed that it was worth far less than the monies owing on it. He moved into the property in order to help complete the renovations (paying market rent to the company). At about this time, the IRD began investigating the company in relation to its GST returns and placed pressure on the director to list the property for sale in order for the company to meet its GST liabilities. This was despite being told that there would be a GST shortfall on any sale under the current market conditions once the debts to the secured creditors had been paid. Eventually, after seeking advice from his solicitor and a financial adviser, the director decided that his best course of action would be to purchase the property in his personal capacity.

On completion of the sale of the property in May 2004 the company was left with no assets and a GST bill to pay. It was placed into liquidation on the application of the Commissioner of Inland Revenue in October 2005.

The claim

In the High Court[5] the liquidators had claimed that the director had been in breach of his duties under sections 131, 135, 136 and 137 of the Companies Act in relation to his management of the company and the sale of the property to himself and had sought orders requiring the director to compensate the company under section 301. The High Court however rejected all of the liquidators' claims.

The liquidators' appeal to the Court of Appeal sought an order for compensation under section 301 based only on a breach of section 136 of the Act. The liquidators argued that by the director selling the property to himself he had created a GST obligation which he knew the company could not meet. In the High Court the liquidators had argued that the issue of incurring the GST obligation was also tied in with allegations of the director's purchase of the property being at an undervalue and the second mortgage to the director's mother not being genuine. These allegations were rejected by the High Court and therefore were not raised on appeal.

The Court of Appeal's decision

The Court of Appeal agreed that the director was in breach of section 136:

- an obligation was incurred by the company; and
- at the time of incurring the obligation the director did not honestly believe on reasonable grounds that the company would be able to perform the obligation when it was required to do so.

The court also rejected the submission made on behalf of the director that for liability under this section to be found the obligation must be viewed in light of the purpose of section 136, namely to compensate those who suffer loss as a result of illegitimate trading. In the court's view this was an issue to be addressed in the context of assessing the director's culpability under section 301 and not for assessing liability under section 136.

However, despite finding the director to be in breach of section 136, the Court of Appeal rejected the liquidators' argument that the High Court judge had not taken into account both stages of the two stage process required for determining the extent of a director's liability under section 301. The court acknowledged that the proper two stage analysis was not explicitly addressed in the High Court's judgment, but in its view the judge had "implicitly" assessed the level of culpability involved in the director's actions having accepted that the purchase of the property by him had triggered a breach of section 136.

The Court of Appeal considered it was appropriate for the High Court in assessing the amount of the director's liability to have considered the director's dilemma: "to allow the insolvent [company] to continue to accrue the holding costs of the property (ie to incur more debt) or to bring the matter to a head by purchasing the property." In this regard the court noted the evidence suggesting that the property was unlikely to sell on the open market for a price which would have cleared the company's debts. Further, the

[5] *Peace and Glory Society Limited (in liq) v Samsa (Hugh Williams J, High Court, Auckland, CIV-2007-404-000700, 2 December 2008)*

IRD in correspondence to the director had effectively required the property to be put on the market. It was also considered relevant that the High Court's findings indicated that the director had purchased the property for fair value and that he had made some attempt to settle the GST liability out of his own funds (albeit for a smaller amount) following the sale of the property. In the court's opinion this indicated that the director had not deliberately chosen a course that was designed to disadvantage the IRD, even though if the director had opted to instead either ask the bank to place the company into receivership or had placed the company into voluntary liquidation the IRD would have recovered the GST as a priority debt.

Having found that the High Court had taken legitimate factors into account in its consideration of the director's contribution under section 301, the court dismissed the appeal.

Lewis v Mason

The Supreme Court has also had to address the issue of determining a director's contribution under section 301 in a recent case[6] involving the long-running *Mason v Lewis* litigation.

Background

This litigation involved two directors, Mr and Mrs Lewis, who had been found by the Court of Appeal in breach of section 135 (the duty not to engage in reckless trading) in relation to the conduct of the affairs of a printing company which had been placed into voluntary liquidation in 2002. This was despite the fact that in the initial hearing the trial judge had concluded that the Lewises had "acted honestly and in good faith throughout the life of the company, and that they had acted as reasonable directors in the circumstances in which they found themselves" and accordingly had found that they were not in breach of their section 135 duty. The directors had played a limited role in the management of the printing company and they had left the day to day operations of the company to an individual who, unbeknown to them, had conducted the company's affairs in a fraudulent manner. However, on appeal, the Court of Appeal held that the case was "a paradigm case of reckless trading" and found both directors liable to contribute under section 301 for their breach of duties under section 135. (The Court of Appeal's decision in *Mason and ors v Lewis* is discussed in the Autumn 2006 issue of Commercial Quarterly.)

The recent Supreme Court decision arose out of the litigation following the Court of Appeal sending the matter back to the High Court to determine the quantum of the Lewises' liability under section 301. The Court of Appeal had not been in position to reach a decision on this issue because of insufficient evidence provided by the liquidators at the initial High Court hearing. However, the Court of Appeal stipulated that the maximum liability of the Lewises was to be capped at $560,000, being the overall amount sought by the liquidators at the initial hearing.

The subsequent High Court case resulted in the Lewises' liability being assessed at 60% of the total creditors' pool (which was over twice the amount of the Court of Appeal's $560,000 cap). The Lewises appealed the High Court's decision to determine whether the High Court had been wrong not to follow the Court of Appeal's stipulation that their liability was not to exceed $560,000. They also argued that the High Court had not taken relevant factors into consideration in exercising its discretion under section 301, particularly with regard to determining the extent of their culpability for the company's losses. The Court of Appeal agreed with the Lewises that the High Court was required to make an award subject to the sum stipulated by it, but rejected their arguments which sought to establish that the appropriate quantum of liability was less than $560,000. (This decision is discussed in the Winter 2009 issue of Commercial Quarterly.) The Lewises appealed this decision to the Supreme Court.

The Supreme Court's decision

The Supreme Court rejected the appeal and made the following points:

- The maximum liability of the Lewises was capped by the Court of Appeal at $560,000 because the liquidators originally only sought that amount. However, that did not preclude the liquidators establishing that the actual level of indebtedness was higher than $560,000;

- The Court of Appeal was correct to include the post-liquidation interest as part of the creditors' pool for the purpose of assessing the liability of the Lewises;

- The Court of Appeal was not wrong in its consideration of the extent the conduct of the directors contributed to causing the creditors' losses noting that: "if the [directors] had properly performed their directors' duties the losses very probably would not have occurred. If they had given proper

[6] Lewis v Mason[2009] NZSC 103

attention to the affairs of the company they would surely have appreciated that it was incurring unsustainable losses." It also agreed with the Court of Appeal's suggested steps which could have been taken by the directors. (See the Winter 2009 issue of Commercial Quarterly article for details of those steps.);

- The argument that the directors' culpability was less than that of a director who committed frauds and should not have been assessed as 60% responsibility "might possibly have some substance" but the Supreme Court was not persuaded that it should make an adjustment given the "total neglect of their duties" and the fact that as a result of the cap the quantum of liability for both directors was already substantially less than 60% of the actual indebtedness.

A few recommendations

Although the outcome of the *Peace and Glory* case may offer some comfort to directors, both it and particularly the *Mason v Lewis* litigation highlight the need for directors to be vigilant in ensuring their actions are not in breach of any statutory duty in insolvency situations.

A director will inevitably have his or her own individual view as to how the company should act if it is heading towards insolvency and whether or not the company should continue trading, but a director should be mindful that his or her actions may result in personal liability if they are undertaken without giving due consideration to the duties they owe to the company and also, potentially, to creditors. The *Mason v Lewis* litigation also provides a clear indication that inaction by directors will not be tolerated by the courts. As the Court of Appeal noted the "days of sleeping directors with merely an investment interest are long gone: the limitation of liability given by incorporation is conditional on proper compliance with a statute."

Key points for directors to keep in mind in the current economic climate include the following:

- A director of a company should ensure they have access to accurate financial information, on a daily basis if required, so as to be always in a position to judge the company's state of health.

- If a director has any concerns as to whether his or her actions are likely to be in breach of the statutory duties, then they should seek advice.

- Where any decision is likely to prejudice the interests of creditors, the directors should seek specific advice on that issue before proceeding with the proposed action.

- When reaching a business judgment as to whether the company should continue trading and incur obligations, the directors are entitled to rely on professional accounting advice. Where that reliance on advice is reasonable (i.e. the advice is obtained from an appropriate adviser, is based on the relevant facts, and is followed), that is likely to be a defence to any allegation of breach of duty.

- A director should record his or her actions carefully, with reasons for the decisions if considered appropriate. That paper trail will be important if the company does become insolvent and the director is required to defend his or her actions.

Securities and capital markets

Increased monetary threshold for share purchase plans
Nearly nine months after the release of a discussion document on the issue, the Securities Commission has finally settled on its revised policy for the share (and unit) purchase plan class exemption set out in the Securities Act (NZX-Share and Unit Purchase Plans) Exemption Notice 2005.

Progress made on the implementation of the new financial advisers' regime
A number of work streams to implement the Financial Advisers Act 2008 and the Financial Service Providers (Registration and Dispute Resolution) Act 2008 are now well underway. In this update, solicitor Debbie Wong outlines the current key developments.

Takeovers Panel issues policy on the approval of independent advisers
In October 2009, the Takeovers Panel issued its current policy for approving applications for the appointment of independent advisers for takeovers and other transactions effected under the Takeovers Code.

Securities and capital markets

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Background

The Securities Act (NZX-Share and Unit Purchase Plans) Exemption Notice 2005 (the 2005 Exemption Notice) was introduced to allow NZX listed issuers (companies and unit trusts) to extend small securities offers to existing security holders without requiring the production of a registered prospectus or investment statement (on the basis that existing security holders will be fully informed about the issuer through the NZX continuous disclosure rules) to a maximum value of $5,000 per security holder per year.

As a full disclosure document is not required, share purchase plans are an inexpensive way of raising capital from existing shareholders. Share purchase plans also allow small shareholders to participate in a capital raising where they may not otherwise have been able to do so because of the cost to the company of preparing a registered prospectus or investment statement and are often used in conjunction with private placements.

In response to recommendations made by the Capital Market Development Taskforce in its November 2008 interim report, the Securities Commission released a discussion document at the end of 2008 to help it decide whether there were useful changes that could be made to assist capital raisings by NZX listed issuers through amendments to the 2005 Exemption Notice. In particular, the Taskforce's interim report suggested that the existing $5,000 per security holder per year limit in the 2005 Exemption Notice should be raised to $25,000.

An important policy consideration for the Securities Commission when it granted the 2005 Exemption Notice was that the class exemption apply only to relatively small offers of securities, so that the individual risk for each security holder was comparatively low. Hence, one of the key concerns raised by the Commission in its 2008 discussion document was that if it agreed to extend the monetary limit for the class exemption from $5,000 to $25,000 the original rationale for the exemption may be undermined (in so far as it may be difficult to regard investments of $25,000 per year as small investments for retail investors).

Another consideration for the Securities Commission was around the benefits of maintaining parity with Australia, especially given the introduction in June 2008 of the mutual recognition regime for trans-Tasman securities offerings. In June 2009, the Australian Securities and Investments Commission (ASIC) extended its annual monetary threshold for share purchase plans to AU$15,000[7] from AU$5,000 per shareholder.

The changes

The Securities Act (NZX-Share and Unit Purchase Plans) Exemption Amendment Notice 2009 which came into force on 25 September 2009 amends the 2005 Exemption Notice by:

- increasing the annual monetary threshold for offers under the 2005 Exemption Notice from $5,000 to $15,000; and
- changing the pricing condition that applies to a share purchase plan or a unit purchase plan when the offer under the share (or unit) purchase plan is made at the same time as, or within 30 days of, a private placement so that the subscription price fixed under the plan also takes into account the lowest price paid by investors under that placement.

A further change prevents the class exemption from applying if any securities of the NZX issuer have been suspended for five trading days or more in the 12 month period before the offer is made. This condition

[7] See Class Order 09/425

has been added as a means of ensuring that only those NZX listed issuers with a good continuous disclosure record are able to take advantage of the class exemption as most suspensions tend to relate to breaches of a listed issuer's disclosure obligations.

Comment

Since the release of its December 2008 discussion document, the Securities Commission has granted exemptions to several individual issuers on the same terms as the 2005 Exemption Notice, but with annual limits of $12,500 per shareholder. The increased monetary threshold in the 2009 amendment notice therefore is not unexpected and we are likely to see this change embraced by listed issuers and investors in future capital raising programmes, especially in the current economic climate.

Until NZX amends its listing rules to accommodate the latest changes to the 2005 Exemption Notice, it will be necessary to apply for a waiver from Rule 7.3.4(c) (previously Rule 7.3.4(ba) prior to NZX's recent renumbering of the Rules) of the NZSX/NZDX or NZAX Listing Rules, as appropriate, to the extent the rule still requires the consideration payable under a share purchase plan to be limited to $5,000 per shareholder.

For further information on share purchase plans refer to an earlier Bell Gully article Changes to increase the benefits of share purchase plans in the Summer 2007 issue of Commercial Quarterly.

Progress made on the implementation of the new financial advisers' regime

A number of work streams to implement the Financial Advisers Act 2008 and the Financial Service Providers (Registration and Dispute Resolution) Act 2008 are now well underway. In this update, solicitor Debbie Wong outlines the current key developments.

The Financial Advisers Act 2008 (the FAA) and the Financial Service Providers (Registration and Dispute Resolution) Act 2008 (the FSP Act) are scheduled to come fully into force by the end of 2010. This legislation introduces significant regulatory requirements that will affect a broad range of businesses. A number of work streams to implement the FAA and the FSP Act are now well underway. The current key developments are outlined below.

Further amending legislation proposed

In October, Commerce Minister Simon Power announced that further technical amendments to the FAA and the FSP Act would be introduced through amending legislation in response to industry concerns about aspects of the new regime. The proposed amendments include:

a) Requiring a qualifying financial entity (QFE) to nominate the individual agents whose advice it will take responsibility for (currently, a QFE may be responsible for all individuals who are its agents at law).

b) Allowing nominated agents of a QFE to provide financial adviser services in relation to the QFE's category 1 products without having to be individually registered or authorised (currently, this is only available for the QFE's employees).

c) Allowing employees and nominated agents of a QFE to provide financial adviser services in relation to products of which the QFE is a promoter (currently, this only available for products of which the QFE is the issuer).

The amending legislation is currently scheduled to be introduced to Parliament in December 2009.

New Commissioner for Financial Advisers appointed

David Mayhew has been appointed the new Commissioner for Financial Advisers for a five-year term which commences on 25 January 2010. He will replace the current Commissioner, Annabel Cotton, who was appointed on a short-term basis while a full-term candidate was found. The Commissioner for Financial Advisers is responsible for overseeing the development of the Code of Professional Conduct and chairing the Disciplinary Committee for authorised financial advisers.

Code Committee appointed

The Financial Advisers Code Committee has been appointed and is currently in the process of drafting the Code of Professional Conduct for authorised financial advisers. However, it has already had two members resign following the release of a Consumer New Zealand report on the finance advice industry in November. The two members were associated with firms which gave advice that was "rejected" in the report and chose to resign to remove the potential for loss of public confidence in the work of the Code Committee.

The Code of Professional Conduct will provide for the professional conduct that must be demonstrated by authorised financial advisers, including minimum standards of competence, knowledge and skills, ethical behaviour and client care. The Code will also provide for continuing professional training requirements. A draft Code is expected to be released for consultation by early 2010.

Consultation papers on minimum standards for authorised financial advisers

The Financial Advisers Code Committee has released two consultation papers on the proposed minimum standards for authorised financial advisers. The first consultation paper seeks feedback on proposed minimum standards of competence, knowledge and skills and the second consultation paper seeks feedback on the proposed minimum standards of ethical behaviour and client care. Submissions on the first

consultation paper were to close on 13 November 2009 but the Code Committee extended the deadline until 27 November 2009 for individuals (or organisations) who requested and were granted an extension by the Committee. Submissions on the second consultation paper close on 18 December 2009.

Discussion document on fees

The Ministry of Economic Development has released a further discussion document on the proposed fees to be charged by government agencies to assist with the implementation and ongoing costs of the new regime. Submissions closed on13 November 2009.

Further information

Bell Gully has prepared a guide to assist with navigating the legislation and determining the extent to which it may apply to various businesses. See the Financial Service Providers Law – Guide which is available on our website.

For further information go to http://www.seccom.govt.nz/invest/financial/consumers.shtml and visit the Code Committee's new website at http://financialadvisercode.govt.nz/

Takeovers Panel issues policy on the approval of independent advisers

In October 2009, the Takeovers Panel issued its current policy for approving applications for the appointment of independent advisers for takeovers and other transactions effected under the Takeovers Code.

Reports by independent advisers are required under several rules of the Takeovers Code. The Code requires directors of a target company to obtain an independent adviser report on the merits of an offer. Independent adviser reports are also required to address fairness between classes where an offer is made for more than one class of security, and to accompany a notice of meeting for any shareholder approval for an increase of control of voting rights in a code company. In some circumstances, an independent adviser is also required to certify that the cash sum proposed as consideration for a compulsory acquisition of securities under the Code is fair and reasonable.

The Takeovers Panel applies criteria relating to both competence and independence in deciding whether to approve advisers to prepare reports under the Code and applications are considered on a case-by-case basis.

In its latest policy statement, the Panel has indicated that it is likely to conclude that the proposed adviser is not independent if the adviser:

- has been involved in giving strategic advice on the relevant transaction to any party;
- is likely to financially benefit from the success or failure of the relevant transaction;
- has an ongoing advisory role or is the current auditor for any party to the relevant transaction; or
- has an interest in any party to the relevant transaction.

However, the fact that the adviser has, in the past, given advice to any party to the transaction will not automatically preclude the adviser from being approved. The Takeovers Panel will assess whether the nature and extent of any prior or existing relationship means that the proposed adviser can be considered sufficiently independent.

Through its approval function the Panel aims to improve the quality of advice given to recipients of takeover offers and to shareholders entitled to vote on Code-related acquisitions and allotments. During the 2008/2009 financial year the Panel processed 23 applications for approval as independent advisers, of which only two were declined.

Applications for the approval of an independent adviser should be submitted to the Takeovers Panel by the proposed independent adviser and are to include the information set out in the Panel's policy statement. The Panel aims to process 80% of these applications within three working days of receiving a complete application.

Although not provided for under the Takeovers Code, or in its latest policy announcement, the Takeovers Panel usually asks to see the independent advisers' reports at a draft stage to assess their quality and to see if they adequately address relevant Code and merits issues.

To view the Takeovers Panel's full policy on independent advisers visit the Panel's website at http://takeovers.govt.nz/who/policy_advisers.htm

Competition and consumer law

Guidance given on the 'failing firm' argument
The Commerce Commission has released its guidelines on 'failing firms', which outline how applications for mergers and acquisitions involving a 'failing firm' argument will be assessed.

Cartels, leniency, markers, and double-dip dobbing
In this article partner Simon Ladd and senior associate Jenny Stevens discuss the Commerce Commission's revised draft leniency policy which was released for public consultation in September. The revised policy introduces two new features, a marker system and a proposed "Amnesty Plus" initiative, which are intended to make the process more transparent and increase the incentives for cartel members to seek leniency.

Time to counter the counterfactual?
In this article, partner Jenny Cooper and solicitor Farzana Nizam discuss the recent Court of Appeal decision in the "0867 proceedings", *Commerce Commission v Telecom Corporation of New Zealand Ltd* [2009] NZCA 338 where questions over the use of the counterfactual test in misuse of market power cases under section 36 of the Commerce Act were raised.

Review of the Credit Contracts and Consumer Finance Act underway
The Ministry of Consumer Affairs has announced a review of the Credit Contracts and Consumer Finance Act 2003 (CCCFA), which has now been in force for over four years with mixed results. The Ministry has released a discussion document highlighting certain issues with the CCCFA and making a number of significant proposals for reform. In this update, partner Jenny Cooper and solicitor Nick Christianson summarise the key issues and proposals most relevant to lenders.

Guidance given on the 'failing firm' argument

The Commerce Commission has released its guidelines on 'failing firms', which outline how applications for mergers and acquisitions involving a 'failing firm' argument will be assessed.

The Commerce Commission will clear a merger or acquisition which does not substantially lessen competition in a market when compared to the level of competition that would exist absent the merger or acquisition.

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, as in both scenarios the target will exit the market and hence there will be no substantial lessening of competition as a result of the acquisition.

While the theory sounds simple enough, its application is not. Making a successful failing firm argument requires an applicant to "satisfy" the Commission that the business is in fact likely to fail, there are no alternative buyers, and the target's assets will exit the market absent the acquisition. 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 1990s – 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's transaction earlier this year although that's not to say we won't see any more in the current economic cycle.

In this context, the guidelines are a useful summary of the evidence the Commission considers relevant. 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 guidelines are intended to outline 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 for businesses in terms of the information the Commission considers relevant. However, as is standard with all guidelines, the failing firm guidelines include the caveat that they are not intended to be a binding statement on the process by which the Commission will reach a decision in any particular situation.

The failing firm guidelines are available on the Commerce Commission's website www.comcom.govt.nz under Business Competition/Mergers and Acquisitions

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Competition and consumer law

Cartels, leniency, markers, and double-dip dobbing

In this article partner Simon Ladd and senior associate Jenny Stevens discuss the Commerce Commission's revised draft leniency policy which was released for public consultation in September. The revised policy introduces two new features, a marker system and a proposed "Amnesty Plus" initiative, which are intended to make the process more transparent and increase the incentives for cartel members to seek leniency.

There are few areas of the law where there is formal provision for a person who has breached a statute to implicate others to escape liability themselves. Competition law is one such area, and the Commerce Commission's "leniency policy" is the cornerstone of its cartel busting toolbox, which it rightly considers "is the most effective tool to uncover cartels". The policy has been very successful. At August 2009, 13 applications had been received under the Commission's policy. Many have related to large international cartels where participants have applied for leniency not only from our Commission but also from other overseas regulators.

Following the success of leniency programmes in other jurisdictions (e.g. the US, EU, Australia), the Commission introduced a leniency policy in 2000. It strengthened that policy in 2004, tailoring it specifically to cartels and making express that the first cartel participant to report a cartel and fully co-operate with the Commission would be granted full immunity from subsequent Commission-initiated proceedings.

The major benefit of applying for leniency under the policy is that the person (corporate or individual) who obtains it is protected from penalties should the Commission issue court proceedings. However, seeking leniency is not without risk. A previously undetected cartel will become the subject of a Commission investigation and if the investigation becomes public, all participants are then subject to possible third party damages claims. There are also significant costs involved in providing the Commission with the necessary co-operation, which should not be underestimated. If the Commission determines full co-operation has not occurred it can withdraw the leniency.

With the benefit of experience, the Commission has reviewed its policy and has released for consultation a revised draft policy introducing two new features, a marker system and Amnesty Plus, which are intended to make the process more transparent and increase the incentives for cartel members to seek leniency.

The key feature of the leniency policy is that it is only the *first* cartel participant to come forward who obtains immunity. This creates a "race for the door" so that a person who is considering whether to seek immunity has to decide quickly. The Commission's proposed marker system operates by allowing a potential applicant who is still collating information to assess whether there has been a breach of the Commerce Act, to secure a place-holder as first applicant for a set period of time, effectively "marking their spot" while they investigate. If on subsequent investigation, it appears no application is necessary, the marker can be withdrawn. Alternatively, the marker can be "perfected" by the applicant then providing the Commission with information about the cartel and proceeding to the formal leniency application process.

The proposed marker system is a welcome addition. It will be a useful mechanism for overcoming the uncertainty that can often exist at the early stages of an investigation as to whether there is a breach of the Commerce Act. The complexity of the assessment is often compounded in cases which involve a number of overseas jurisdictions and/or historical facts. It can take considerable time for internal investigations to be completed. Parties can now protect themselves while those internal investigations continue by seeking a marker.

The Commission considers its proposed "Amnesty Plus" initiative will increase the incentive for cartel participants to approach the Commission. A participant in a cartel already being investigated by the Commission (who does not have leniency for that cartel) can obtain a significant reduction in penalty by informing the Commission of their participation in another separate cartel of which the Commission was previously unaware. The applicant would then receive both leniency for the new cartel and a lesser penalty as a cooperating party for the initial cartel. Amnesty Plus is a feature of some overseas regulators' leniency policies and is a scenario that those authorities (in particular the US DOJ) have seen arise in practice. It is a useful further addition to the Commission's policy that may encourage more co-operation and disclosure of cartel activity.

In addition to these positive new initiatives, we consider that the Commission's review of its leniency policy provides an opportunity to make additional changes to the policy:

- To provide greater transparency around Amnesty Plus, the revised policy could include greater specificity as to the type of factors that the Commission would usually consider to determine the additional discount for co-operation regarding the first cartel and the potential level of that additional discount.
- Further changes could be made to the conditions for leniency to bring our policy in line with those of Australia, the US and EU. At present in New Zealand, the Commission must be unaware of the existence of the cartel at the time when the leniency application is made. A more flexible approach would be to adopt one similar to Australia's which allows for leniency applications where if at the time the Australian Competition and Consumer Commission receives the application, it has not received written legal advice that it has sufficient evidence to commence cartel proceedings (i.e., there is no requirement that the ACCC is completely unaware of the alleged cartel).
- The current leniency policy provides that immunity is not available to any person who has coerced other participants to take part in the cartel. Other jurisdictions also exclude leniency for "ringleaders". We submitted that a leader should also be excluded in New Zealand in circumstances where the party's role as leader can be clearly and objectively demonstrated.
- The Commission could provide a greater level of comfort in its policy as to when it can be expected to assert privilege for its own written records of oral leniency applications and what specific steps the Commission would take to protect an applicant's confidential information. In our experience the confidentiality of leniency and co-operation applications and of the information subsequently provided to the Commission is a very serious concern for potential applicants. It would assist potential applicants if the Commission provided greater clarity as to the steps it would be prepared to take.

Submissions on the Commerce Commission's revised draft leniency policy closed on 30 October 2009.

To view Bell Gully's submission, click here.

This article was first published in NZ Lawyer, 16 October 2009.

Time to counter the counterfactual?

In this article, partner Jenny Cooper and solicitor Farzana Nizam discuss the recent Court of Appeal decision in the "0867 proceedings", Commerce Commission v Telecom Corporation of New Zealand Ltd [2009] NZCA 338 where questions over the use of the counterfactual test in misuse of market power cases under section 36 of the Commerce Act were raised.

Questions over the use of the counterfactual test in misuse of market power cases under section 36 of the Commerce Act have been raised in the recent Court of Appeal decision in the "0867 proceedings", *Commerce Commission v Telecom Corporation of New Zealand Ltd* [2009] NZCA 338.

In declining the Commission's appeal, the Court of Appeal expressed discomfort with the counterfactual test applied by the Privy Council in earlier cases. The Commission has announced that it will seek leave to appeal, asking the Supreme Court to reconsider the use of the counterfactual test as the sole test for determining misuse of market power cases and to adopt a more flexible approach in sync with Australian law and reflecting the views of Parliament that a less restrictive approach should be taken when section 36 was amended in 2001.

Factual background

In 1999, Telecom introduced changes to its calling system to encourage residential customers to move to the Telecom network. Residential customers using an 0867 dial-code would not be charged for their calls to internet service providers (ISPs). An ISP then lost its right to claim termination fees from Telecom relating to that call. Where residential customers sought to call an ISP without using the 0867 dial-code, they would be required to pay a two cent per minute fee to Telecom after 10 hours of internet use. The Commission alleged that Telecom had breached section 36 of the Act (as it stood at the time) by using its dominant position in the market for an anti-competitive purpose, preventing or deterring its competitors from engaging in competitive conduct by reducing or eliminating the termination fees that would have otherwise been payable to its competitors.

High Court decision

To show that section 36 had been contravened, three elements needed to be proved:

1. Telecom had a dominant position in the relevant market;
2. Telecom had used that position; and
3. That use was for an anti-competitive purpose.

The High Court found that, while Telecom did enjoy a dominant position in the market at the relevant time, Telecom did not "use" that position in the required competition law sense. It reached this conclusion by applying a counterfactual analysis comparing the actual situation with a hypothetical scenario in which Telecom was not dominant but the market was otherwise the same. On the basis of this analysis, the court found that Telecom could rationally have acted in the same way and introduced the 0867 system even if it had not had a dominant position in the market.

The High Court followed the decisions of the Privy Council in *Telecom Corporation of New Zealand Ltd v Clear Communications Ltd* [1995] 1 NZLR 385 and *Carter Holt Harvey Building Products Group Ltd v Commerce Commission*, [2006] 1 NZLR 145, which held that a counterfactual test must be applied in assessing s 36 cases. In the latter case, the Privy Council stated (at [60]):

"It is, as the Board said in *Telecom Corporation of New Zealand Ltd v Clear Communications Ltd* at p 403, both legitimate and necessary when giving effect to s 36 to apply the counterfactual test to determine whether the defendant has used its position of dominance."

The High Court also found that, even if Telecom had used its dominant position, it did not do so for an anti-competitive purpose, as the introduction of the calling charges had been somewhat motivated by a need to reduce congestion on Telecom's network.

The arguments on appeal

On appeal, the Commission contended that the counterfactual test should not be the *sole* test for determining whether use had been made of a dominant position. The Commission referred to a number of decisions of the High Court of Australia, where the counterfactual test had not been regarded as the sole test for determining use of a dominant position, including the:

- "materially facilitated" approach in the judgment of the majority of the court in *Melway Publishing Pty Ltd v Robert Hicks Pty Ltd* (2001) 205 CLR 1; and
- direct observation approach suggested by Deane J in *Queensland Wire Industries Pty Ltd v Broken Hill Pty Co Ltd* (1989) 167 CLR 177.

The "materially facilitated" approach proposes that it may be appropriate to conclude that a firm has taken advantage of its market power, where (at [51]):

"[I]t does something that is materially facilitated by the existence of the power, even though it may not have been absolutely impossible without the power. To that extent, one may accept the submission made on behalf of the ACCC, intervening in the present case, that s 46 would be contravened if the market power which a corporation had made it easier for the corporation to act for the proscribed purpose than otherwise would be the case."

The direct observation approach is based on the proposition that directly observing what had occurred would be sufficient to decide whether a firm had taken advantage of its market power.

The Commission submitted that, rather than always applying the counterfactual test, the court should be able to also refer to these other approaches.

The Court of Appeal's decision

The Court of Appeal was sympathetic to the Commission's arguments for a more flexible approach, but concluded that, in light of the Privy Council decisions, any change of approach should be made by the Supreme Court. Applying the counterfactual test, the court held that Telecom had not misused its dominant position in the defined market.

The court was clearly uncomfortable with the counterfactual test. It noted that the assumptions that needed to be made for the test to work correctly could be difficult to get right, and that applying those assumptions in a particular case could be unrealistic. In the court's concluding comments, Justice Hammond said:

"This case exposes the realities of the difficulty of counterfactual analysis and that it is not always of utility in the context of a case such as the present. The reality of the case is that it is about terminating charges which are markedly above cost and the willingness of Telecom, under threat of regulation, to share its monopoly rents with Clear. Any realistic counterfactual must take monopoly rents as a given. It is difficult to see how there can be any plausible counterfactual about the distribution of monopoly rents where non-dominance has to be assumed: in the absence of dominance there can be no monopoly rents."

Conclusion

Although section 36 has been amended since 1999, the counterfactual approach has been applied to the amended section 36, despite Parliament's intention to take a more flexible approach than the Privy Council (see *Commerce Commission v Bay of Plenty Electricity Ltd* (unreported, High Court, Wellington, 13 December 2007, CIV 2001-485-917, Clifford J and Professor M Richardson). If leave to appeal to the Supreme Court is granted (and it should be), the comments of the Court of Appeal will provide a clear opportunity for the Supreme Court to determine whether the Privy Council's approach should continue.

This article was first published in NZLawyer, 18 September 2009.

Review of the Credit Contracts and Consumer Finance Act underway

The Ministry of Consumer Affairs has announced a review of the Credit Contracts and Consumer Finance Act 2003 (CCCFA), which has now been in force for over four years with mixed results. The Ministry has released a discussion document highlighting certain issues with the CCCFA and making a number of significant proposals for reform[8]. In this update, partner Jenny Cooper and solicitor Nick Christianson summarise the key issues and proposals most relevant to lenders.

The review provides an ideal opportunity for lenders to make submissions on the Act's operation to date, as well as on the proposals for reform.

Disclosure

- *Tension between the five day disclosure period and the borrower's right to cancel.*
- *Additional disclosure of the terms of credit related insurance.*
- *Additional disclosure of prepayment fees and their calculation.*
- *Additional disclosure of the cost of making minimum payments.*

A principal policy goal of the CCCFA is to promote efficiency and competition in the consumer credit market by requiring creditors to disclose certain information to borrowers so that they can compare loan products and make informed decisions. The Ministry has identified four issues with the operation of the current disclosure regime.

First, allowing a five day period for creditors to provide the required disclosure is seen as being in tension with the borrower's right to cancel the contract after receiving disclosure. The Ministry gives the example of motor vehicle finance where, because the lender and the vehicle trader are independent, the consumer enters into two separate contracts: one for the purchase of the vehicle and one for the finance to purchase, of which only the latter is subject to a right of cancellation. It is conceivable (indeed likely) that a borrower will enter into motor vehicle finance and take possession of the vehicle before the mandatory disclosure is given. Where the borrower has misunderstood the terms of the credit contract and subsequently exercises their right to cancel it, they are likely to have difficulty in trying to return the vehicle. To avoid this situation the Ministry proposes amending the CCCFA to require immediate CCCFA disclosure where purchasers of motor vehicles access credit at the time of their purchase.

Secondly, while the CCCFA requires a creditor to provide a borrower with a copy of the terms of any credit related insurance required and arranged by the creditor under a credit contract, it does not specify what constitutes disclosure, nor does it provide a basis for assessing the adequacy of that disclosure. The Ministry proposes extending the general disclosure requirements to cover the disclosure of credit related insurance.

Thirdly, the Ministry has noted that borrowers appear to enter into credit contracts without being fully aware of the potential cost of repaying their loan early and suggests that more extensive disclosure may be required. The Ministry refers to the Private Members Bill put forward earlier this year by Aaron Gilmore MP as once possible approach.[9] The proposal in that Bill would involve creditors disclosing a schedule or matrix of prepayment fees calculated over a range of possible interest rates over various points in the life of a credit contract, and would prevent the amendment of the prepayment formula after the credit contract is made. While this proposal would give further information to borrowers about the possible fees they could be charged, its effect would be to indirectly limit the formulae open to creditors under the CCCFA, given that the current CCCFA regime does not require that prepayment fee formulae be linked directly to interest rates. An alternative proposal is to require creditors to disclose a schedule of prepayment fees and an explanation for them, although there are questions about the necessary complexity of such information

[8] Available at www.consumeraffairs.govt.nz

[9] Credit Contracts and Consumer Finance (Break Fees Disclosure) Amendment Bill

and therefore whether it would even be accessible (and useful) to borrowers. The Ministry does not provide any detail about how such proposals would be expected to work in practice.

Finally, the Ministry suggests that credit card users do not appreciate the true cost of the interest that accrues when they make only the "minimum payment", and proposes that credit card issuers be required to provide disclosure of that cost with each monthly bill.

Credit fees

- *The meaning of an "unreasonable" fee.*
- *Frontloading of fees.*
- *Extending the time limit for bringing a claim to annul or reduce an unreasonable fee.*
- *Restricting third party fees to arm's length relationships.*

The Ministry has raised four issues in respect of credit fees. First, the Ministry says that the credit fee provisions of the CCCFA are based on the principle that fees cannot be "unreasonable", and that this approach creates some uncertainty and lack of clarity about what is properly included in fees. The Ministry points to the Commerce Commission's draft guidelines[10] on its approach to enforcing the fee provisions of the CCCFA as helping to provide clarity to the industry. However, the Commission's views on the proper interpretation and application of the CCCFA can be more restrictive than the CCCFA itself. The alternative is to impose more prescriptive requirements in the CCCFA.

Secondly, the Ministry has questioned whether the CCCFA should be amended to clarify that fees for services should only be payable when the service is due to be performed or once the service has been performed, rather than being "frontloaded" as an upfront cost at the inception of a loan.

Thirdly, the Ministry notes that an application to the court to annul or reduce a credit or default fee that is unreasonable must be made within one year of the day on which the fee is imposed. The Ministry has proposed either lengthening the limitation period or removing it and allowing the Limitation Act 1950 to apply.

Finally, in respect of third party fees passed on by a creditor to a borrower, the Ministry suspects that some such fees are not genuinely third party fees but are instead being used to avoid the unreasonable credit fees test, and proposes amending the CCCFA to require that third party fees may only be passed on to the borrower if they come from a third party that is in an arm's length relationship to the creditor.

Other issues raised

There are a number of further proposals made in the Ministry's discussion document, including:

1. Extending the hardship provisions of the CCCFA to allow borrowers to apply to vary a credit contract even when in default (by no more than two months).
2. Putting in place time frames within which creditors must respond to (five days) and process (20 days) applications under the hardship provisions.
3. Prohibiting fees for making hardship applications.
4. Requiring disclosure of information on the hardship provisions under the CCCFA initial disclosure regime.
5. Restricting unsolicited credit increases to "opt-in" only.

The Discussion Document also includes discussion of proposed amendments in respect of pawnbroking and the Secondhand Dealers and Pawnbrokers Act and the Credit (Repossession) Act 1997, and a review of fringe lending practices, none of which are covered here.

Submissions for the discussion document closed on 16 November 2009.

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[10] Available at www.comcom.govt.nz

Intellectual property and information technology

Madrid is coming to New Zealand
New Zealand is one of the few countries in the developed world which has not yet joined the Madrid Protocol, which provides a system of international registration for trade marks. However, as senior associate Colleen Cavanagh outlines in this article, this is set to change.

Ringleaders punished for role in "largest pharmaceutical spamming operation in the history of the internet"
New Zealand's anti-spam agency is hailing a major success after the High Court awarded significant penalties against two local men involved in what is being described as the "largest pharmaceutical spamming operation in the history of the internet".

Madrid is coming to New Zealand

New Zealand is one of the few countries in the developed world which has not yet joined the Madrid Protocol, which provides a system of international registration for trade marks. However, as senior associate Colleen Cavanagh outlines in this article, this is set to change.

The Trade Marks (International Treaties and Enforcement) Amendment Bill, which, amongst other things, will amend our Trade Marks Act 2002 to allow for Madrid Protocol applications to be filed in New Zealand, was introduced into Parliament in September 2008. The Bill passed its first reading in Parliament in April 2009 and was referred to the Foreign Affairs, Defence and Trade Select Committee which reported the Bill back to Parliament on 13 September 2009. The committee recommended that the Ministry of Economic Development implement all aspects of the legislation, including the Madrid trade mark registration system, expeditiously. However, before the Madrid system can come into force in New Zealand, regulations governing implementation and operation of the system need to be written. Furthermore the Intellectual Property Office of New Zealand (IPONZ) needs to prepare to administer the system. As a result it is unlikely that Madrid will be implemented in New Zealand before early 2011.

What is the Madrid system?

The Madrid system is governed by two treaties – the Madrid Agreement and the Madrid Protocol and it is administered by the International Bureau (IB) of the World Intellectual Property Organisation (WIPO) in Geneva, Switzerland. The Madrid Agreement concerning international registration of trade marks dates back to 1891 but the Madrid Protocol relating to the Madrid Agreement became operational in April 1996. Initially signatories were mainly European countries but today many countries around the world, including many of New Zealand's trading partners have become members. Today there are over 80 signatories (contracting states) to Madrid.

Simply stated the system provides trade mark owners with a simplified method of applying for protection of a trade mark in many countries by filing a single trade mark application in one language and by paying a single set of fees instead of filing separate applications and paying separate fees in each of those countries. The filing of a Madrid application can be made without enlisting legal representation in each country. Although some companies do make a conscious decision not to use the system (more about possible disadvantages of the system are discussed below), many trade mark owners are attracted by the potential savings and simpler procedures of filings under the Madrid Protocol as compared to national or regional filings.

How does the system work?

When the Madrid Protocol comes into effect in New Zealand, trade mark owners who qualify will be able to file an application with IPONZ (the originating office) and nominate the overseas countries for which trade mark protection is desired – provided those countries are also members of the Madrid Protocol. The applicant for an international application must live in, be a national of, or carry on business in, the member country.

The local trade marks office certifies (this will be IPONZ in New Zealand) that the international application details are the same as the national application and sends it to the IB. The IB does not examine applications for substantive matters but checks fees and formalities and if no irregularities are found grants the international registration. Once the IB grants the international registration it notifies the originating office and sends a certificate to the applicant and advises the national offices of the nominated countries. The national offices then have between 12 and 18 months to examine the application according to their own domestic trade mark legislation. If there are any objections raised during this examination process or if oppositions are filed by third parties, the nominated country must inform the IB which in turn informs the applicant. If no objections are raised the nominated country gives effect to the international registration as if it were a trade mark registered as a result of a national application.

Of course not only will New Zealand brand owners be able to potentially benefit by this change but also overseas trade mark owners will be able to use the Madrid Protocol to protect their brands in New Zealand.

What are the advantages and disadvantages?

Clearly the Madrid system brings convenience and potential cost savings to applicants. However, there are pros and cons to be weighed up before an applicant elects to file under Madrid.

Certain parameters must be met for an international application to be valid:

- the mark in the Madrid application must be the same as in the basic application;
- the applicant of the Madrid application must be the same as the proprietor of the basic application; and
- the goods and/or services in the Madrid application must be within the scope of the basic application.

As the mark in the international application must be the same as in the basic application and the same for each country nominated in the international application, Madrid Protocol filings may not be suitable where a mark is to be used in different languages in different countries. For example, a New Zealand business wishing to register a translation or transliteration of its trade mark in China will not be able to include China in an international application filed in New Zealand for the same mark in English.

Furthermore, some large businesses with operations in various countries like to organise ownership of trade marks by different companies within the group. In view of the requirement that the applicant for the international application must be the same as in the basic application, these businesses will have to decide whether to use the Madrid system which will require one of the companies becoming the common owner of the brand in all of the countries, or to file outside the Madrid system.

As the goods and services in the Madrid application must be the same as, or narrower than that of the basic application, this means that protection in all of the countries nominated will need to be aligned to that in the basic application. Should broader coverage be required in some countries than can be achieved in the basic application, the Madrid system may not be the best option for the applicant.

Another risk that the Madrid protocol brings with it is what is known as "central attack". After the expiry of the first five years the international registration will become independent of the basic application. However, for the first five years from the date of an international registration, anything that affects the basic application also affects all of the nominations of the international registration. Accordingly, should the basic application be refused or come under attack resulting in a limitation in its scope, this will also affect the scope of protection in all of the nominated countries. If the basic application is successfully opposed or cancelled, then the rights in the designated countries will also fail. This is a downside of the system.

If the basic application does collapse, the trade mark owner can request that the international registration be transformed into national applications in some or all of the nominated countries. These applications are then treated as if they were filed on the filing date of the international registration but can be subject to re-examination by the respective trade marks offices depending on how far examination of the international application had progressed before the date of transformation. Additional transformation fees will be payable at this stage and a foreign agent will likely have to be appointed to represent the owner in each country.

There are of course advantages of the system and one is that the international registration has one registration date and is renewed as a single registration. A single renewal is filed with the IB and the renewal is effective for all nominated countries.

Although this single renewal system applies, it must be noted that maintenance of protection in some jurisdictions will still involve more than simple renewal, for example a United States registration must still be maintained by filing declarations of use at the 6th and 10th anniversaries of the registration, as happens with a stand alone U.S. registration. Furthermore with no U.S. agent likely having been appointed in securing the international registration, there will be no agent watching out for these types of deadlines.

Another advantage is that any changes in the name or address of the trade mark owner need only be notified to the IB which in turn notifies the office of each jurisdiction covered by the registration. The owner does not have to arrange for such changes to be recorded individually.

International registrations are assignable in whole or in part but there are restrictions on the transferee. The new owner must be incorporated in, a citizen of, be domiciled in or have a "real and effective industrial or commercial establishment in" a contracting state to the Madrid Protocol at the time of the application to record the change in ownership. If this is not the case then the IB will not record the change in ownership.

This limitation on transferability of international registrations potentially has a significant impact on the value of a trade mark and can create complications in structuring transfers in future. It is therefore important that trade mark owners appreciate this at the outset.

Final word

In conclusion, this new development in the trade mark law in New Zealand, whilst not suiting all businesses, will for many open the door to a simplified, cost effective solution to obtaining widespread protection for brands.

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Ringleaders punished for role in "largest pharmaceutical spamming operation in the history of the internet"

New Zealand's anti-spam agency is hailing a major success after the High Court awarded significant penalties against two local men involved in what is being described as the "largest pharmaceutical spamming operation in the history of the internet".

The Department of Internal Affairs (DIA) issued proceedings against Shane Atkinson of Christchurch and courier Ronald Smits for their part in a major international spamming operation. The pair admitted breaching the Unsolicited Electronic Messages Act 2007 and Shane Atkinson was ordered to pay $100,000 and Roland Smits to pay $50,000 in penalties.

This is the second time the DIA has successfully sought pecuniary penalties under the anti-spam legislation. The first penalty was imposed against Lance Atkinson, Shane Atkinson's brother, in December last year for his part in the same operation.

DIA says the penalties mark the end of Operation King Herbal, an investigation conducted by its Anti-Spam Compliance Unit which began in December 2007 when it raided four Christchurch properties and seized 22 computers owned by a Christchurch business, run by the Atkinson brothers. The business sent more than two million unsolicited emails over a four month period to New Zealand addresses, marketing pharmaceutical products. This was merely the New Zealand component of what the DIA says is "the largest pharmaceutical spamming operation in the history of the internet". The DIA worked with overseas agencies, particularly the United States' Federal Trade Commission, to conclude the investigation. Lance Atkinson is also facing court action in the United States brought by the Federal Trade Commission.

** Bell Gully's ICT team has provided comprehensive advice on the Unsolicited Electronic Messages Act 2007 and related issues.*

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Utilities and resources

The changing face of the NZ ETS
On 25 November 2009 Parliament passed the Climate Change Response (Moderated Emissions Trading) Bill (the Amendment Bill). As its title suggests, the Climate Change Response (Moderated Emissions Trading) Act 2009 (the ETS Moderation Act) does not seek to re-invent the framework for the New Zealand Emissions Trading Scheme (NZ ETS). Rather it moderates the impact that the NZ ETS, established by the Climate Change Response (Emissions Trading) Act 2008, has on business in the first few years at least. In this article, senior associate Kate Radka outlines the key changes brought about by the ETS Moderation Act and discusses their significance.

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Last minute changes to the Amendment Bill

The Finance and Expenditure Select Committee released its report on the Amendment Bill on 16 November 2009. The Committee was unable to reach agreement on the suitability of the Amendment Bill, and accordingly the report contained no majority recommendations and no amendments to the text of the Amendment Bill.

With little chance of securing a deal with Labour in time to have the Amendment Bill passed prior to the New Zealand delegation heading to Copenhagen in December, National secured the support of the Māori party. In exchange for the Māori party's support, National has agreed to:

- the inclusion of a comprehensive Treaty of Waitangi clause;
- changes to the deforestation liabilities that iwi owners of pre-1990 forests would otherwise face under the NZ ETS;
- an agreement for iwi to enter contracts to plant forests on marginal Department of Conservation or other Crown-owned land, including an afforestation fund to cover the cost of the planting;
- measures to improve outcomes for Māori businesses in fishing, farming and forestry; and
- support for vulnerable households.

Amendments resulting from these negotiations as well as amendments to address technical and drafting issues raised during the select committee process were introduced by way of Supplementary Order Papers delivered on the floor of the House on 24 November 2009.

Delays to sector entry dates

As foreshadowed in our Winter 2009 Commercial Quarterly, the ETS Moderation Act delays the entry of the stationary energy and industrial processes sectors into the NZ ETS by six months to 1 July 2010. The delay was recommended by the NZ ETS review committee to enable the allocation plan for trade-exposed businesses to be finalised prior to the energy and industrial sectors' introduction into the NZ ETS. That said, with the changes to the allocation model and the need to implement regulations prior to consulting on and finalising an allocation plan, officials will be hard-pressed to have a finalised allocation plan in place before the entry date of 1 July 2010.

The delay to the entry of the energy and industrial sectors is relatively good news for firms in those sectors which would otherwise have faced uncertainty over the impact of the NZ ETS on their costs of production. However, it is not welcomed by foresters and other prospective vendors of emission units (including those international trading banks and other traders selling units into New Zealand), which would have expected stationary energy and industrial sector participants to be strong early purchasers of their emission units.

The entry date for the agriculture sector has also been delayed from 2013 to 1 January 2015, with the point of obligation being placed at the processor rather than farm level (although Parliament may place it at the farm level in future), thus decreasing the number of prospective purchasers of emissions units from that sector. This is good news for those looking to trade units into New Zealand to the extent that it will be easier to target bigger bundles of emission units to a smaller and more readily identifiable number of buyers.

Conversely, the liquid fossil fuel sector's entry date has been brought forward six months, and this sector will now enter the NZ ETS at the same time as the energy and the industrial sectors.

Transition phase

One of the most significant changes brought about by the ETS Moderation Act is the introduction of a transition phase to operate until 31 December 2012, which moderates the impact of the NZ ETS on businesses with compliance obligations in the energy, liquid fossil fuel and industrial sectors. The transition phase will have a significant impact on the demand from these sectors for emission units in the short term, with the imposition of:

- a 50% obligation (i.e. to surrender only one unit for every two tonnes of CO_2-e emitted); and
- a NZ$25 fixed price option (whereby businesses can opt to pay the Government NZ$25 for emission units that would be surrendered immediately as opposed to buying emission units from the market).

To ensure that the NZ$25 fixed price option does not result in the New Zealand Government in effect subsidising businesses or governments in other countries to meet their compliance obligations, the export of New Zealand Units (NZUs) – which would be converted to AAUs for the purposes of export – will not be permitted during the transition phase unless the NZUs/AAUs are those awarded to forestry participants under the NZ ETS or the Permanent Forest Sink Initiative (PFSI). This restriction, along with the 50% obligation and $25 fixed price option, is unlikely to be welcomed by prospective purchasers of NZUs/AAUs (including those international trading banks and other traders purchasing units from New Zealand) as it significantly reduces the number of emission units that will be available for sale and delivery in the short term.

Although the transition phase is due to end on 31 December 2012, the commentary to the Amendment Bill and other official reports foreshadow the possibility, should the NZ ETS and Australian Carbon Pollution Reduction Scheme (CPRS) align, that a price cap and associated prohibition on trading outside of New Zealand and Australia may be implemented during an initial period of such alignment. With the CPRS far from settled, this remains a possibility only, but one which international traders are likely to oppose and therefore something to watch with interest.

Allocation to emissions-intensive trade-exposed (EITE) businesses

The ETS Moderation Act changes the absolute emissions basis of allocation for trade-exposed businesses to an emissions intensity model, which closely aligns the free allocation models in the NZ ETS and the proposed CPRS. Under such a model, an eligible business will be allocated emission units to cover up to 90% of its emissions in the first couple of years, with the percentage of Government-allocated emission units reducing slowly over time. While the newly proposed emissions intensity model allows for allocations to increase/decrease in line with production levels, there is still an incentive to improve energy efficiency as allocations will be based on an "industry average" for energy intensity.

It is likely that the defined EITE activities will mimic those, to the extent possible, already defined in Australia. Whilst this provides some guidance to those who consider themselves to be carrying out activities which are EITE, the list of defined activities is not yet complete in Australia and the regulations have yet to be released for consultation in New Zealand. Understandably, businesses in the industrial processes sector are eagerly awaiting the release of the regulations to have some certainty as to whether EITE allocation will be available for one or more of the activities they carry out and if so, the extent of that allocation.

Impact on foresters

Other than the changes brought about by the Supplementary Order Papers, the ETS Moderation Act in essence changes very little in relation to the forestry sector, which entered into the NZ ETS with effect from 1 January 2008. Whilst the transition phase 50% obligation applies to the energy, liquid fossil fuel and industrial sectors, the forestry sector still has a "100%" obligation to surrender one unit per emission for any deforestation of pre-1990 forests, or net carbon stock decrease for those foresters who opt in to the NZ ETS in relation to their post-1989 forests.

The transition phase price cap of NZ$25 is not welcomed by the forestry sector, although the prohibition on international trading of non-forestry NZUs/AAUs does support domestic trading to an extent (albeit it effectively caps the price at NZ$25). We expect foresters will focus on international trading, particularly to international trading banks, businesses in Japan and the United States, as well as governments in Europe.

Will the Government need to buy units?

While the ETS Moderation Act moderates the impact of the NZ ETS on businesses with compliance obligations, it results in the Government and ultimately the taxpayer carrying the slack. With an emissions intensity based allocation model with no fixed pool of units and a transition phase that reduces compliance obligations for energy intensive sectors by 50%, the Government bears a greater risk of having to front up

with emission units should New Zealand as a nation not meet its Kyoto target for CP1. Without detailed reporting from emissions-intensive trade-exposed entities and evidence of renewed forestry planting it will be difficult for officials to forecast accurately the Government's needs. There is a reasonable possibility that the New Zealand Government will be seeking to purchase emission units to meet any shortfall arising in CP1 as a result of a moderation of the NZ ETS.

Linking with Australia

Many of the changes introduced by the ETS Moderation Act are designed to enable the NZ ETS and the proposed CPRS to link in the short to medium term. While there are benefits in linking with Australia, not to mention wider economic benefits in reducing the possibility of carbon leakage to Australia, there is a danger associated with mimicking aspects of the proposed CPRS to enable alignment when the legislation in Australia is by no means certain. It is possible that New Zealand's moderated ETS may, although currently aligned with important aspects of the CPRS, differ significantly from the final shape of the CPRS emerging out of the negotiations between the major political parties in Australia.

Bell Gully's climate change team is available to advise in detail on the NZ ETS and its implications, and on carbon trading in general.

Bell Gully partner Simon Watt, an expert in climate change issues, including emissions trading, has been advising New Zealand and international organisations for a decade as they become involved in trading or prepare for new climate change laws.

One of just seven lawyers world-wide identified as leading legal experts in climate change by researchers, he was called upon by TV3's Nightline news programme on 26 November to help explain the new emissions trading scheme.

View the news clip.

Bell Gully News

Bell Gully first New Zealand firm to be awarded full Asia Pacific top rankings
Bell Gully has become the first New Zealand law firm to secure top tier rankings across all practice areas in a single year after the release of the latest Asia Pacific Legal 500 guide.

Shear investment raises thousands in Shave for a Cure
Support for New Zealanders with leukaemia and their families has been boosted with the raising of just over $75,000 in the annual Bell Gully and PricewaterhouseCoopers Shave for a Cure event.

Former PM has launched Bell Gully Women Leaders' series
Former Prime Minister the Rt Hon Dame Jenny Shipley launched a Bell Gully initiative aimed at encouraging women into leadership.

Useful web links

New Zealand Government

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

New Zealand regulatory agencies and organisations

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

New Zealand commercial sites

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

Australian sites

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

International sites

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