



BELL GULLY

Financial Services Quarterly

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Welcome to the Spring 2007 issue of *Financial Services Quarterly*, a review of current legal issues in the financial sector.

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

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- **Insolvency – a summary of the latest news from the courts and legislators.**
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Need more information?

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IN THE COURTS

Enforceability of a guarantee

A financier lent almost \$2 million to a company to refinance debt and to finance a new development. When the company went into liquidation, the guarantor argued that his liability under the guarantee was extinguished when a second loan was advanced to a related company.

Voidable preference not found where another company's debt was paid

When a company in financial difficulty paid another company's debt, no voidable preference was found because the debt paid was not its own.

Guarantee not dependent on maintenance of security

A guarantor argued that failure by the lessor to disclose levels of leased stock to the guarantor rendered the guarantee ineffective.

If you want a guarantee, get a guarantee signed

A loan recorded in an "investment certificate" which stated that security included a personal guarantee was not a guarantee.

IN THE JOURNALS

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In this article, the author criticises the trend of including non-assignment clauses in contracts in the context of receivables financing.

Adjustment in global markets

The IMF's latest global financial stability report has indicated that the recent difficulties in the US subprime mortgage markets have created turbulence that will have a ripple effect in global markets.

LEGISLATION/IN PARLIAMENT

Voluntary administration

Significant developments have been made in corporate insolvency law in New Zealand with the introduction of the voluntary administration scheme on 1 November.

Property securities law changes

In January 2008, the Property Law Act 2007 comes into force. Financiers are advised to review their documentation and practices in light of the new laws.

New powers for trustees of finance companies

The law has been changed to strengthen the position of trustees of finance companies. The changes, which came into force in September, are intended to assist trustees in performing their supervisory roles in the interests of investors.

Reserve Bank to register all deposit-takers

All deposit-takers will have to be registered by the Reserve Bank and comply with minimum prudential requirements under a new regulatory framework.

Phoenix company laws tighten

The Companies Amendment Act 2006 introduced a number of provisions dealing with phoenix companies.

Amendments to the Companies Act

A summary of amendments made to the Companies Act in June and September.

Amendments to the Financial Reporting Act

A summary of amendments made to the Financial Reporting Act in June and August.

New Insolvency Act to come into force in December

The Insolvency Act 2006 will come into force on 3 December, replacing the Insolvency Act 1967.

Minority buy-out provisions for dissenting shareholders to be clarified

A new bill introduced by Commerce Minister Lianne Dalziel amends the Companies Act 1993 to clarify the minority buy-out provisions for dissenting shareholders in times of a special resolution.

Changes to the PPSA

The Personal Property Securities Amendment Act 2007 came into force on 19 September.

Securities Act class exemption review complete

The Securities Commission has completed its five-yearly review of class exemptions from the Securities Act.

RECENT DEVELOPMENTS

Insolvency

A summary of the latest news from the courts and legislators.

Companies Office releases online voluntary administration service

Administrators are able to notify the Registrar of Companies of their appointment and manage their portfolios using the administration, receivership and liquidation service online.

New Zealand's financial system resilient

The Reserve Bank has released its Financial Stability Report assessing the health of the New Zealand financial system

Finance companies report compliance

When asked to report to the Securities Commission in August, all but one of 67 finance companies reported that their current prospectuses complied with the law and were not false or misleading.

Code of Banking Practice revised

The Code of Banking Practice, which records good banking practices, including minimum standards that New Zealand member banks agree to preserve, has been revised.

Financial Reporting Programme – Cycle 5

The Securities Commission has reviewed financial reports prepared in accordance with NZ IFRS and under previous NZ GAAP.

Delay of mandatory adoption of IFRS

The Accounting Standards Review Board has resolved that companies that satisfy certain criteria are permitted to continue to apply the existing New Zealand Financial Reporting Standards until further notice.

No duplicate filing obligations for companies carrying on business in New Zealand and Australia

The New Zealand and Australian governments have enacted legislation to remove duplicate filing obligations for companies carrying on business in both New Zealand and Australia.

Liquidation not possible if company removed from register

A company will now have to be restored to the register before it can be put into liquidation.

New website to assist investors

The Securities Commission will soon launch a new website aimed at assisting people to make better investment decisions.

New business portal launched

A new government website designed to promote good business practices and to make it easier for New Zealand companies to do business has been launched.

Independent audit regulation and oversight in New Zealand

The Minister of Commerce agreed that a letter sent from the Securities Commission and the big four accounting firms asking for priority to be given to the discussion paper on audit regulation should be published.

New PPSR website

A new look Personal Property Securities Register website is scheduled for launch later this year.

IN THE COURTS

Enforceability of a guarantee

In this case¹, a financier lent almost \$2 million to a company to refinance debt and to finance a new development. When the company went into liquidation, the guarantor argued that his liability under the guarantee was extinguished when a second loan was advanced to a related company.

The company's sole director and shareholder guaranteed the company's debt.

When the company was subsequently put into liquidation, the financier demanded payment by the guarantor, who failed to pay.

At around the same time, the financier entered into a separate transaction under which it loaned another company (the second company) \$9,750,000 to purchase and develop a motor camp and to repay amounts owing by the transferee company to the financier. This loan was also guaranteed by the guarantor.

The financier sought summary judgment as to the guarantor's liability to pay under the guarantee in respect of the original company's debt, and the guarantor argued that:

- it was agreed that the original company's debt would be paid out of the second company's funding;
- his liability as guarantor ceased when the debt was novated or transferred to the second company;
- the original debt was paid in full (and the guarantee accordingly extinguished) when the financier received a fee of \$1.5 million (which exceeded the amount of the claim) pursuant to the loan agreement between the financier and the second company.

The financier disputed the guarantor's arguments and contended that there were two separate debts.

The court decided that:

- There was no evidence of any dealings between the guarantor and the liquidator subsequent to the liquidation and before the second company loan was entered into.
- A shareholders' agreement presented in connection with the second company loan explicitly recorded that the original debt remained in place, that the guarantee extended to subsequent advances made by the financier to the company after it was placed in liquidation and that a "separate" loan facility was being put in place with the second company.

The application for summary judgment was accordingly successful.

¹ *Lombard Finance & Investments Limited v Nisbet* High Court, Wellington, CIV 2006-485-2836, 16 May, 2007

Voidable preference not found where another company's debt was paid

When a company in financial difficulty paid another company's debt, no voidable preference was found because the debt paid was not its own.

In this case, a company (the payer) paid over \$280,000 to a finance company. The money was not owed by the payer, but by another company that owed the money to the financier (the debtor) and who, in turn, the payer owed money to. The payment was intended to reduce the amount owed by the payer to the debtor.

At the time the payer made the payment, it was unable to pay its due debts. The payer's liquidators took proceedings against the finance company, seeking to have the payment set aside as a voidable transaction under section 292 of the Companies Act 1993, which requires that the following criteria are met:

- the payment must qualify as a "transaction", which includes the "payment of money by the company";
- the payment must be made at a time when the company was unable to pay its due debts;
- the payment must be made within the "specified period" of two years prior to the commencement of liquidation;
- the payment must enable another person to receive more towards satisfaction of a debt than would otherwise have been (or likely to have been) received in liquidation; and
- the payment must not be in the ordinary course of business.

The penultimate bullet point proved to be the main stumbling block for the liquidators in this case, since the payment was not made in satisfaction of any actual debt owed by the payer.

Guarantee not dependent on maintenance of security

A guarantor argued that failure by the lessor to disclose levels of leased stock to the guarantor rendered the guarantee ineffective.

In this case¹, a finance company rented equipment to a company. When the company went into liquidation, the finance company failed to recover the full amount due to it from sale of the equipment and sought summary judgment for the balance from the guarantors.

The guarantors argued that the finance company had a legal duty to carry out regular stock-takes and to advise the guarantors if there were any discrepancies.

The court decided that the stock-taking arrangements were for the finance company's benefit, and not the guarantors', and, in the absence of express provision, it could not be shown that the guarantee was dependent on maintenance of security by the finance company.

¹ *GE Finance & Insurance v MacPherson Properties & Anor*, High Court, 27 July 2007

If you want a guarantee, get a guarantee signed

A loan recorded in an “investment certificate” which stated that security included a personal guarantee was not a guarantee.

In this case¹, loans were advanced to a series of companies that carried out tourism activities in Rotorua. The loans were recorded in “investment certificates”, which stated that security included a personal guarantee given by the director of the companies.

When the companies went into receivership and were unable to repay the loans, the lender claimed that the investment certificates included a binding personal guarantee by the director.

The director opposed summary judgment, claiming that although it was a term of the loans that security would be given, including a personal guarantee, the investment certificates were not of themselves guarantees and were not signed by the director as personal guarantor.

The court determined that the certificates were primarily a record of the terms of the loans and it was not clear that they contained an operative guarantee. The director clearly signed the certificates in his capacity as director but there was no clear extrinsic evidence that he was accepting an independent obligation at the time of signing.

¹ *Gibbons v Summers High Court, Rotorua, CIV 2007-463-202, 28 September 2007*

IN THE JOURNALS

The effectiveness of contractual restrictions on the assignment of contractual debts

Peter Zonneveld, Butterworths Journal of International Banking and Financial Law, June 2007, Volume 22, No 6

In this article, the author criticises the trend of including non-assignment clauses in contracts in the context of receivables financing.

Mr Zonneveld believes that free assignability of debts is for the good of the market economy and is concerned at the trend of debtors to include non-assignment clauses in their contracts.

The article sets out:

- the benefits of receivables financing;
- the reasons behind the use of non-assignment clauses; and
- the English law position around non-assignment clauses.

Benefits of receivables financing

Receivables financing is an important financial tool for businesses needing to resolve short term liquidity problems or pursuing more favourable balance sheet treatment. It encourages the supply of goods to customers in developing countries on the basis that the ultimate credit risk can be picked up by a third party who has the “credit risk appetite” in those particular circumstances and is therefore good for international trade.

Reasons behind the use of non-assignment clauses

A debtor may only wish to deal with a particular creditor and may want to retain rights to set off and the right to raise counterclaims against that creditor. Debtors run the risk of losing these options if their contracts are assigned to a third party.

Conclusion

The author considers the balance to be struck between the freedom of contractual parties to agree the terms of their contract and the free assignability of debts. He concludes that the balance should be weighted in favour of the free assignability of debts for the good of the market economy.

Adjustment in global markets

Reported in Australian Corporate News, Issue 19, 10 October 2007 – source: Global Markets Face Protracted Adjustment, IMF Survey online, 24 September 2007

The IMF's latest global financial stability report has indicated that the recent difficulties in the US subprime mortgage market have created turbulence that will have a ripple effect in global markets.

The report anticipates a difficult period ahead, as credit contraction is likely to have broader economic effects. It is suggested that the framework of the market also needs strengthening, meaning that markets generally are likely to go through a protracted adjustment period.

Although some central banks have acted to stabilise and alleviate the effect on the broader economy, the report indicates that the adjustment process is likely to take some time, and that there will need to be some changes to practice in the structured credit markets.

The report goes on to suggest that policy makers should refine their prudential frameworks to ensure investors and institutions maintain high credit standards and strengthen risk management systems in good times as well as bad. It is suggested that this be achieved through preserving the benefits experienced from innovative financial products.

Key components of the prudential framework include (among others):

- greater transparency;
- better risk monitoring;
- improvement by rating agencies; and
- better valuation of complex products.

IMF's Counsellor and Director of the Monetary and Capital Markets Department, Jaime Caruana commented that "this does not require, as some have suggested, a new regulatory paradigm, but we must be ready to re-examine some elements of the framework we have, and to enhance it where necessary".

LEGISLATION/IN PARLIAMENT

Voluntary administration

Significant developments have been made in corporate insolvency law in New Zealand with the introduction of the voluntary administration (VA) scheme on 1 November.

The objective of the VA scheme is to provide an alternative rehabilitative model to maximise the prospects of a company's continuing existence. If rehabilitation is not possible, it will provide an alternative to immediate liquidation where it is considered that VA will provide a better return for creditors.

In general terms, the process of VA is as follows:

- Administration commences on the appointment of the administrator, who may be appointed by the board of directors, a secured creditor who has a charge over all or substantially all of the company's property, a liquidator or the courts (on application by a creditor or the Registrar of Companies).
- The company's directors' powers are suspended, and the administrator controls the business, property, and affairs of the company.
- A moratorium is imposed on creditors taking any action against the company, or an owner or lessor of property occupied or used by the company seeking to repossess the property, unless the creditor, owner, or lessor has commenced an enforcement action prior to the administration commencing.
- A secured creditor may not enforce a charge over the company's property unless the secured creditor holds a charge over all or substantially all of the company's property and the creditor takes enforcement action within the first 10 working days of being notified of the appointment of the administrator.
- Without the administrator's consent or a court order, a transaction or dealing that affects the company's property is void, a person may not commence or continue court proceedings against the company, shareholders cannot transfer any shares, and rights and liabilities of shareholders cannot be changed.
- A lender may not enforce a guarantee in respect of the company's liabilities given by a director or their spouse or relative (without a court order).
- A creditors' meeting must be called shortly after the commencement of the administration at which the creditors will decide whether to appoint a creditors' committee and, if so, to appoint its members and decide whether to replace the administrator.
- A "Watershed Meeting" must then be called by the administrator who is required to recommend to the company whether:
 - a deed of company arrangement (DOCA) should be entered into (and the details of the proposed DOCA decided);
 - the administration be terminated; or
 - the company be placed into liquidation.
- The creditors then vote on whether to accept the administrator's recommendation or to approve an alternative option.
- If a DOCA is approved, it will bind all unsecured creditors, all secured creditors who voted for it, all owners or lessors of the property who voted for it, the company, its directors and shareholders, and the deed administrator.
- If a DOCA is approved, the administrator is replaced by a deed administrator (who is often the original administrator), who then takes over the management of the company.

- While a DOCA is in force, no person bound by it may seek to liquidate the company, issue or continue court proceedings against the company or commence or continue enforcement action against company assets.

The administration ends when:

- the time period for a Watershed Meeting expires without such a meeting taking place;
- the creditors vote against a DOCA at a Watershed Meeting;
- a DOCA is executed; or
- the court orders otherwise.

The alternative options to the VA scheme remain unchanged. They include compromises with creditors, court approved arrangements, amalgamations or compromises, receivership and liquidation. The VA scheme has clear advantages for companies over these existing alternatives, although it is not known to what extent the VA scheme will be preferred in New Zealand.

Property securities law changes

In January 2008, the Property Law Act 2007 comes into force. Financiers are advised to review their documentation and practices in light of the new laws.

The Property Law Act 2007 (the new Act) replaces the Property Law Act 1952 (the old Act).

Property affected

Whereas the old Act applied to mortgages over land, the new Act also extends to mortgages over personal property. However, to the extent that the new Act overlaps with the Personal Property Securities Act (the PPSA), the provisions of the PPSA will prevail.

Covenants

The new Act implies a series of covenants into all mortgages entered into on or after 1 January 2008. It is possible to vary, or to explicitly exclude, the covenants.

Priority for further advances

The new Act codifies the existing common law on priorities for further advances under a first mortgage after a second mortgage is entered into. Any doubt as to what constitutes a “further advance” is intended to be removed by section 93 of the new Act. The old Act’s “section 80A priority amount” is retained in section 92 of the new Act.

Security over amounts expended for protection and realisation of security

Under the new Act, mortgages will secure amounts advanced by the mortgagee in relation to the protection and realisation of its security. For example, amounts expended in repairing the property, entering into possession etc.

Restriction on acceleration for default

The new Act restricts the rights of a mortgagee to accelerate a debt by reason of a default. Unless the loan is a true “on demand” facility, 20 working days notice must have expired without remedy before the debt can be accelerated.

Duties on power of sale

The new Act clarifies that the duty of a mortgagee to obtain the best price reasonably obtainable at the time of mortgagee sale extends to parties other than the mortgagor (for example, subsequent mortgagees and guarantors).

In addition, mortgagees will now be able to step in as the vendor under an existing agreement for sale and purchase of mortgaged property.

Application of sale proceeds is also now covered specifically, with the new Act requiring payment of any surplus to subsequent equitable mortgagees (including holders of general security agreements extending to land) before payment to the mortgagor.

Action

Financiers are advised to review their documentation and their enforcement practices to ensure compliance with, and proper reference to, the new Act.

If you would like more information on the new Property Law Act, contact [Hugh Kettle](#) or [Rachel Gowing](#)

New powers for trustees of finance companies

The law has been changed to strengthen the position of trustees of finance companies. The changes, which came into force in September, are intended to assist trustees in performing their supervisory roles in the interests of investors.

Many of the changes were already set out in the Trustee Corporations Association guidelines and in some trust deeds, but some deeds did not contain all of the powers that trustees needed. The Securities Commission met with all finance company trustees before proposing the changes.

The Securities Commission's acting Chairman stated that "it is important that trustees have up-to-date and reliable information about the companies they supervise". The changes have been made to ensure that all trust deeds provide trustees with robust powers to get the information they need to carry out their duties in investors' interests.

Summary of changes

Finance companies must:

- provide the trustee with regular reports about the issuer's financial position;
- regularly certify compliance with the trust deed;
- keep the trustee informed on matters relevant to the trustee's duties;
- have the borrowing group's half-yearly financial statements audited (unless this requirement is waived by the trustee, in which case they must be reviewed);
- copy to the trustee the borrowing group's annual and half-yearly financial statements;
- consult the trustee on the appointment of auditors and advise the trustee if an auditor declines appointment or reappointment or resigns; and
- include specific conditions in the terms of appointment of auditors, giving the auditors responsibilities to the trustee.

The trustee will have power to:

- appoint an independent auditor; and
- appoint an expert to assist the trustee to determine the true financial position of an issuer.

The changes automatically become part of all finance company trust deeds (including existing deeds).

Reserve Bank to register all deposit-takers

All deposit takers will have to be registered by the Reserve Bank and comply with minimum prudential requirements under a new regulatory framework.

The framework, announced by Finance Minister Michael Cullen, will apply to non-bank deposit-takers, including finance companies, building societies and credit unions. The framework is the result of a major review of regulations and it is expected that it will be some time before legislation is implemented. "This is not intended to be a "quick fix" solution and it will not solve all the problems that some finance companies are currently facing" Michael Cullen said.

The requirements will include:

- A credit rating from a rating agency approved by the Reserve Bank;
- a minimum amount of capital of \$2 million;
- the need for a capital ratio, measured on a standardised and comprehensive basis;
- restrictions on lending to persons that are related to the deposit-takers; and
- fit and proper requirements for the directors and senior managers of deposit-takers.

Legislation required to implement mandatory credit ratings is expected to be introduced into Parliament this year, but there is nothing to prevent deposit-takers obtaining a credit rating now.

Small deposit-takers (those with total assets under \$10 million) will be exempt from requiring a credit rating, but will have to disclose prominently that they are unrated. The government has expressed its commitment to working with the private sector to help ordinary depositors understand credit ratings and disclosure statements.

Deposit-takers will continue to be subject to trust deeds and to be supervised by trustee corporations under the Securities Act, but trust deeds will have to comply with the new prudential requirements. Deposit-takers will also continue to be subject to public disclosure under the Securities Act, but this will be strengthened, and made more focused and user-friendly.

Phoenix company laws tighten

The Companies Amendment Act 2006 introduced a number of provisions dealing with phoenix companies.

The amendments prohibit a person who was a director of a company placed in liquidation (because it was unable to pay its debts) within the preceding five years from incorporating a new company under a former name or a similar name to that of the failed company. The person must have been a director within 12 months from the commencement of the liquidation.

Penalties for breaching these provisions are up to five years imprisonment or a fine not exceeding \$200,000.

Amendments to the Companies Act

A summary of amendments made to the Companies Act in June and September.

The Companies Amendment Act (No2) 2006 Commencement Order 2007 (No 2007/108) was gazetted on 17 May 2007.

On 18 June 2007, amendments to the Companies Act 1993 (the Act) came into force that:

- extend the grounds for disqualification for directors to include other jurisdictions - if a director, promoter or “person concerned or taking part in the management of the company” has been prohibited from that position in a prescribed country then they will now be disqualified from being a director under the Act;
- provide that non-active entities are not required to be audited or to prepare or make available annual reports or financial statements (non active entities have not derived any income, expenses, disposed of any assets or are party to another transaction); and
- provide for companies to send a notice about the availability of their annual report, rather than the annual report itself.

On 1 September 2007, amendments to the Act came into force that:

- allow the Registrar to approve the use of different forms for the purposes of Part 18 of the Act (overseas companies obligations - use of name, change of constitution, file annual return and comply with Financial Reporting Act 1993, notification of cessation to carrying on business in New Zealand – see new section 332A); and
- exempt an overseas company from the requirement to give information or a document to the Registrar if that company is incorporated in a prescribed jurisdiction, the information or document is held by the Registrar in that jurisdiction and the information or document is within a prescribed class.

Amendments to the Financial Reporting Act

A summary of amendments made to the Financial Reporting Act in June and August.

The Financial Reporting Amendment Act 2006 Commencement Order 2007 (No 2007/110) was gazetted on 17 May 2007.

On 18 June 2007, amendments to the Financial Reporting Act 1993 (the Act) came into effect that:

- exempt directors of non-active entities from the requirement to prepare financial statements;
- allow the Securities Commission to grant exemptions to:
 - recipients of money from conduit issuers (who would otherwise be issuers);
 - directors of issuers incorporated outside New Zealand; and
 - directors of overseas companies that are not issuers; and
- provide for infringement offences.

On 11 August 2007, amendments to the Act came into effect that extend the definition of “issuer” in the Act to include certain persons that receive money from a conduit issuer.

New Insolvency Act to come into force in December

The Insolvency Act 2006 will come into force on 3 December, replacing the Insolvency Act 1967.

The changes made by the new Act are summarised as follows:

- A new alternative to bankruptcy is introduced. Consumer type debtors can seek entry into the No Asset Procedure (NAP) if they have no assets of any realisable value, no means of repaying their creditors, debts of between \$1,000 and \$40,000, have not been bankrupt or entered the NAP before, and have no trust involvement.
- Responsibility for administration of the Summary Instalment Order (SIO) regime is transferred from the District Court to the Official Assignee. SIOs give debtors with the means to pay their creditors a time frame to do so in order to avoid bankruptcy. The debt threshold for SIOs is increased to \$40,000, with the period for repayment capable of being extended to five years under special circumstances.
- Responsibility for receipt of debtor petitions for bankruptcy is transferred to the Official Assignee.
- Entry into bankruptcy, NAP or SIO requires debtors to submit a Statement of Affairs with the application, which can be completed either manually or electronically.
- Where a bankruptcy is initiated by a creditor's petition, discharge will occur three years after receipt by the Official Assignee of a satisfactory Statement of Affairs.

Minority buy-out provisions for dissenting shareholders to be clarified

A new bill introduced by Commerce Minister Lianne Dalziel amends the Companies Act 1993 to clarify the minority buy-out provisions for dissenting shareholders in times of a special resolution.

The key objective of the Companies (Minority Buy-out Rights) Amendment Bill (167-1) is to improve the practical operations of the minority buy-out regime to ensure it functions efficiently, cost effectively, and appropriately.

Changes to the PPSA

The Personal Property Securities Amendment Act 2007 came into force on 19 September.

The changes:

- specifically allow use of a job title (as opposed to a person's name) for the contact person of a debtor or a secured party, in each case where it is in an organisation;
- include job title as part of the searchable criteria on the Personal Property Securities Register; and
- extend the list of those who can search the database to include the Registrar for any purpose related to the Registrar's functions, duties and powers.

Securities Act class exemption review complete

The Securities Commission has completed its five-yearly review of class exemptions from the Securities Act.

Most exemptions were renewed on substantially the same terms, but more substantive changes were made to the following exemptions:

- Securities Act (Building Societies) Exemption Notice 2002;
- Securities Act (Contributory Mortgage Brokers) Exemption Notice 1983; and
- Securities Act (Overseas Employment Share Purchase Schemes) Exemption Notice 2002.

In addition, the Commission created a new class exemption for public offerings made by companies listed on, or applying to be listed on, markets operated by New Zealand Exchange Limited.

The Commission is also working on changes to its class exemptions on residential property developments, real property proportionate ownership schemes, and rights, options and convertible securities.

For more information on the review and on the changes, click [here](#).

RECENT DEVELOPMENTS

Insolvency - latest news from the courts and legislators

Amendments to Companies Act to come into force

Amendments to the Companies Act came into force on 1 November 2007, resulting in the long awaited introduction of the voluntary administration regime, new phoenix company provisions, significant amendments to the voidable transaction regime and new liquidator reporting requirements.

Companies (Voluntary Administration) Regulations 2007

The Companies (Voluntary Administration) Regulations 2007 came into force on 1 November 2007. The regulations prescribe the provisions that are deemed to be included in all deeds of company arrangements (unless specifically excluded) along with a form for the administrator's six-monthly report.

The introduction of voluntary administration will impact on those who deal with companies facing financial uncertainty, particularly financial institutions and secured creditors.

Insolvency Act 2006 Regulations

Regulations are required under the Insolvency Act 2006 before it can be brought into force. These are currently being drafted and it is expected the Insolvency Act 2006 will come into effect sometime in December.

Insolvency (Cross-Border) Act 2006

The Insolvency (Cross-Border) Act 2006 will not come into effect until Australia adopts the UNCITRAL Model Law on cross-border insolvency in its insolvency legislation. The Cross-Border Insolvency Bill 2007 (Aus) was introduced into Federal Parliament in Australia on 20 September 2007 and has received its second reading. It is not yet clear when this Bill will be passed.

Regulating Insolvency Practitioners

The introduction of voluntary administration has increased calls for a system to regulate insolvency practitioners. The insolvency law reforms that came into force on 1 November have been criticised for failing to deal with this issue.

The primary concern is that a small number of insolvency practitioners do not have the necessary integrity, knowledge and skills to be able to competently carry out corporate insolvencies, including voluntary administrations. A second discussion document has been released by the Ministry of Economic Development including the following three proposals for regulating insolvency practitioners:

- strengthening the Companies Act 1993 by increasing the supervisory role of the Registrar of Companies, the remedies available to the court in the event of misconduct, and tightening reporting requirements for liquidators;
- introducing a voluntary accreditation regime; or
- introducing a mandatory licensing regime regulated by an independent body.

Strengthening the existing legislation

Some suggest that concerns about the competence of insolvency practitioners can be met by simply strengthening existing legislation. For example, the Companies Amendment Act extends the ability to ban a person from acting as liquidator. In making a prohibition order the court may now consider any previous breaches of duty by an insolvency practitioner, not simply those within the last five years (as had previously been the case). It may also prohibit a person from acting as a liquidator for an indefinite period. The problem with these provisions is the cost and difficulty of obtaining an order when it is likely to be opposed. Parties dealing with a recalcitrant liquidator may not have the funds or patience required to obtain an order.

Further reforms include removing the provision allowing liquidators to escape their obligation to file reports if returns to unsecured creditors are unlikely to be more than 20 cents in the dollar, and requiring liquidators to send a list of creditors to all creditors to assist them in organising themselves collectively.

Such measures are designed to increase the detection of breaches of duty and to strengthen the responses to them. However, these measures do nothing to ensure that only those with sufficient skill and knowledge are appointed to manage insolvencies in the first place, so that the risk of a breach occurring is minimised from the outset.

Voluntary accreditation

Under a voluntary accreditation scheme, an agency would be authorised to certify that individuals have acquired a sufficient level of skill and experience to conduct insolvencies. There is no prohibition stopping non-accredited individuals from practising, but they would not be able to represent themselves as certified practitioners. Accredited individuals may be subject to the rules of the accrediting agency.

A voluntary scheme has some benefit in that it enables the public to determine whether an insolvency practitioner is likely to have sufficient competence to manage an insolvency. This will be of particular benefit to petitioning creditors with the right to appoint a liquidator. The scheme provides little benefit to creditors who cannot control who is appointed as liquidator and who may face an insolvency administered by an incompetent, non-accredited insolvency practitioner.

Licensing

Under a licensing regime only licensed practitioners would be permitted to carry out insolvencies. The regime could take one of two forms. Like Australia, the regime could be overseen by a new, single licensing authority. Alternatively, a competitive licensing system could be introduced which would involve the establishment of an approval body that permits any number of bodies to compete with each other for the membership of insolvency practitioners. Membership to any one body would be compulsory to practice. The existing bodies most likely to participate in a competitive licensing scheme are the Institute of Chartered Accountants and the Law Society.

The main criticism of a licensing regime is that it will add to the cost of all insolvencies. The total cost of a new licensing scheme for insolvency practitioners could be considerable, especially given the relatively small number of insolvency practitioners in New Zealand. Ultimately, these costs will be passed on to creditors. It is questionable whether these costs are outweighed by the benefits of regulation. Some of these costs could be minimised, however, through a competitive licensing scheme, as the existing rules and disciplinary processes of bodies such as the Institute of Chartered Accountants and the Law Society could be used.

The Ministry has requested submissions on these proposals and arrangements for transferring from the current regime to the chosen regime.

When is a transaction preferential?

The recent decision of the Court of Appeal in *Levin v Market Square Trust*¹ represents an important development for determining whether a transaction is preferential in accordance with the Companies Act.

In the case, the company in liquidation (the lessee) leased business premises from another company (the lessor). The lessor made demand for payment of rent arrears. The lessee failed to pay and advised that it had entered into an agreement to sell its business (the Agreement) to a third company (the purchaser). The Agreement was conditional on the lessor's consent to the assignment of the lease.

The lessor advised that it would consent to an assignment provided arrears were paid immediately. As a result, it was agreed between the purchaser and the lessee that the purchaser would pay the arrears to the lessor.

¹ [2007] 3 NZLR 591; (2007) 10 NZCLC 264,282

Following the liquidation of the lessee, the liquidator served a notice on the lessor claiming the payment to it by the purchaser was a voidable transaction by the lessee in terms of section 292 of the Companies Act.

Was the payment a "transaction" by the lessee?

The High Court declined to set aside the payment. The judge reasoned that the payment by the purchaser to the lessor was not money which it owed to the lessee under the Agreement because at the time of the payment the Agreement was not unconditional. The judge held that as the lessee never had any entitlement to the money paid it could never have been available in the pool of assets for distribution to other creditors.

The Court of Appeal decision

The Court of Appeal overturned the High Court's decision, holding that the payment made to the lessor was made out of the lessee's money, pursuant to a separate loan agreement entered into by the purchaser and the lessee to enable the rent arrears owed to the lessor to be paid. This loan agreement provided that the sum lent would be "deducted from the purchase price for the business" on settlement but that "should the sale of the business to the purchaser not proceed for any reason, then those further monies will be refunded to the purchaser immediately".

Legal discussion

In its judgment the Court of Appeal held the only thing a liquidator must show is that the creditor received a greater payment than it would have otherwise received in the liquidation. Section 292 requires a comparison between the amount the creditor actually received from the company and the amount that the creditor would have received as part of the general body of creditors in the liquidation had the payment not been made. Overruling the decision of the High Court in *National Bank of New Zealand v Coyle*² the court held that the section did not require the general body of creditors to be worse off as a result.

The court also upheld the decision in *Porter Hire Ltd v Blanchett*³ in which it was held that the degree of any preference is to be measured against what creditors would receive in the actual liquidation. The court considered that the hypothetical liquidation concept would impose considerable practical difficulties on liquidators.

It was argued that this would unfairly result in a creditor being held accountable for events concerning the company after the transaction that the creditor had no control over. The court rejected this concern and held that:

"... the legislature has addressed that issue by defining the specified period prior to liquidation in which transactions of this kind may be voidable. And, in any event, considerations of fairness do not arise at this stage of the s292(2)(b) assessment. That assessment is purely objective. Considerations of fairness (using that concept loosely) arise later in the regime, when the court is considering what orders, if any, to make under s295 or whether to deny the liquidator recovery under s296(3). Under s296(3) the question of whether the creditor has notice of the insolvent state of the company will be directly relevant to determining whether the payment has been received in good faith."

Two key preference testers

The decision confirms two key points. First, that a liquidator need only show that a creditor has received a greater payment than it would have otherwise received in the liquidation. It is not a requirement of s292(2)(b) that the general body of creditors be worse off.

Secondly, the test for preference involves a comparison of what the creditor has received against what it is likely to have received in the actual, not hypothetical, liquidation of the company.

² (1999) 8 NZCLC 262,100

³ High Court Auckland, Associate Judge J P Doogue CIV 2005-404-3056, 24 July 2006

The importance of impartiality

The case of *Esoon Limited v Grieve and Jollands and Anor*⁴ and is a reminder to liquidators of the importance of being seen to be impartial when carrying out duties under the Companies Act 1993.

In this case, a company (Williams) had undertaken business with another (Esoon) and when Williams failed to pay its invoices an adjudication under the Construction Contracts Act 2002 was held and Williams was ordered to pay Esoon \$90,395.86. Subsequent to the order, Williams was placed into liquidation by special resolution of its shareholders.

Esoon filed a proof of debt with the liquidators for the adjudication award. On the same day, the liquidators declined Esoon's claim on the basis of a set-off. Esoon's debt in the liquidation was entered at \$849.25.

Esoon issued proceedings, challenging the liquidators' decision to admit its debt only to the extent of the set-off sum and seeking orders that the liquidator be replaced and awarding indemnity costs against the liquidators.

Partiality

Esoon claimed there was a close association between the shareholders of Williams, who appointed the liquidators, and the liquidators themselves, and that the Esoon claim had been rejected quickly without proper investigation into the alleged cross-claim by Williams. It was claimed that all of this suggested that the liquidators had not acted impartially. In response, the liquidators conceded that no set off should have been allowed and indicated that they intended to resign. The liquidators did not oppose the appointment of Esoon's solicitor as liquidator in their place.

However, the court considered that the same concerns about partiality would arise if Esoon's solicitor or anyone else with a close association with Esoon was appointed. It is important that any liquidator appointed be seen to have the impartiality required to carry out their duties under the Companies Act. The court therefore held that a notice of resignation by the existing liquidators and a consent to act on behalf of a replacement liquidator should be filed. Following this, an order would be made appointing new liquidators. The court stated the newly appointed liquidators should be independent, and if possible, relatively senior, given the need to review the actions of the current liquidators.

Indemnity costs

No order was made for indemnity costs against the liquidators personally. The court was not prepared to make adverse findings as to partiality without first giving the liquidators an opportunity to explain their conduct. However, the judge was satisfied that there was prima facie evidence of partiality. Leave was therefore granted to Esoon to make a formal application for orders in relation to the liquidators' actions. The liquidators would then need to respond fully by stating what they did and why.

Tip for next time

It is inappropriate to appoint a liquidator that has a close association with the appointing party and while this in and of itself does not indicate partiality, it is important that liquidators be seen to be impartial in carrying out their duties.

⁴ [\(2007\) 10 NZCLC 264,277](#)

Companies Office releases online voluntary administration service

Administrators are able to notify the Registrar of Companies of their appointment and manage their portfolios using the administration, receivership and liquidation service online.

The Companies Office has announced the introduction of a new online service for voluntary administration.

Using the online service, administrators can give notice of their appointment and manage their portfolios.

For more information about the service, go to www.companies.govt.nz.

New Zealand's financial system resilient

The Reserve Bank has released its Financial Stability Report assessing the health of the New Zealand financial system.

Reserve Bank Governor Dr Alan Bollard stated that the financial system is sound and has been reasonably resilient against a back-drop of worldwide market volatility. “Failure by borrowers in the US sub-prime mortgage market to meet their payments led to more widespread financial market volatility. As a result, the cost of risk has increased and liquidity has reduced”.

The report notes that liquidity in the New Zealand dollar foreign exchange and interbank markets was tightly stretched in August, and the Reserve Bank stepped in to ensure the interbank market could trade normally.

Noting that, given its large external debt, New Zealand is heavily reliant on foreign capital markets, Dr Bollard said that recent events highlight the importance of liquidity for institutions and the financial system as a whole, and that important lessons were to be learned. Foreign capital markets may not be as secure and liquid as previously thought.

The Reserve Bank is commencing work on a specific liquidity policy for banks, which is expected to be introduced next year.

However, it was noted that banks' asset quality remains in good shape, and profits continue to increase in line with growth in bank lending. But risks to financial stability remain due to low household saving. Debt and debt-service ratios continue to rise, making households and the financial sector vulnerable to a housing market correction.

Reserve Bank Deputy Governor Grant Spencer concluded that “despite the substantial impact of recent events on non-bank depositors, the failures are unlikely to have broader negative effects on the financial system and the economy”.

Code of Banking Practice revised

The Code of Banking Practice, which records good banking practices, including minimum standards that New Zealand member banks agree to preserve, has been revised.

Areas that have been amended include:

- the provision of guarantees and other securities; and
- clarification that securities providers have the right to request that the amount of their liability is limited and that banks must inform them of this right.

A new section on internet banking is also included.

A copy of the revised code is available on the New Zealand Bankers' Association website at www.nzba.org.nz

Financial Reporting Programme – Cycle 5

The Securities Commission has reviewed financial reports prepared in accordance with NZ IFRS and under previous NZ GAAP.

The review included 12 financial statements prepared in accordance with NZ IFRS and 28 prepared under previous NZ GAAP.

Key issues identified included:

- presenting the correction of prior period errors as transition adjustments;
- incorrect labelling of comparatives; and
- the treatment of GST in the preparation of the cash flow statement.

The Commission has reported its pleasure with the cooperation from issuers and their willingness to improve the quality of their financial reporting.

Delay of mandatory adoption of IFRS

The Accounting Standards Review Board has resolved that companies that satisfy certain criteria are permitted to continue to apply the existing New Zealand Financial Reporting Standards until further notice.

The Board has resolved that companies satisfying all of the following criteria are permitted to continue to apply the existing New Zealand Financial Reporting Standards and are therefore not required to apply NZ IFRS for periods beginning after 1 January 2007, until further notice:

- the company is not an issuer (as defined in the Financial Reporting Act 1993 (the Act));
- the company is not required by section 19 of the Act to file its financial statements with the Registrar of Companies; and
- the company is not large (as defined in the Act).

To date, NZ IFRS has been adopted by large issuers, subsidiaries of overseas companies that are complying with IFRS and the public sector. The applicability to small entities has generated a lot of international debate and in New Zealand the Minister of Commerce has announced that a government review of the financial reporting requirements for small to medium sized companies will commence in mid-2008.

The board has therefore decided to delay mandatory adoption pending the outcome of the review.

No duplicate filing obligations for companies carrying on business in New Zealand and Australia

The New Zealand and Australian governments have enacted legislation to remove duplicate filing obligations for companies carrying on business in both New Zealand and Australia.

The amendments, which came into force on 1 September 2007, mean that both the New Zealand Companies Office and the Australian Securities & Investments Commission can now receive information relating to companies operating on both sides of the Tasman and through a data exchange. This will reduce the cost and time of doing business.

The New Zealand Companies Office will also be providing an online service to enable Australian incorporated companies intending to carry on business in New Zealand to register as an overseas company in New Zealand. This service will be easier, quicker and more cost-effective than the manual process.

Liquidation not possible if company removed from register

A company will now have to be restored to the register before it can be put into liquidation.

The Companies Amendment Act 2007 came into force on 19 September. This repealed section 327 of the Companies Act 1993 which allowed, in effect, the liquidation (by order of the High Court) of assets remaining in the name of a company that had been removed from the register. Such assets were deemed to revert from crown ownership to allow this to take place.

This means that a company will now have to be restored to the register before it can be put into liquidation and this will require an application to the Registrar under section 328 or to the High Court under section 329.

New website to assist investors

The Securities Commission will soon launch a new website aimed at assisting people to make better investment decisions.

The website is expected to answer such questions as:

- What types of investment are available?
- What risks are involved in investing?
- Why is my personal financial situation important when I plan to invest?
- What fees will I have to pay?
- What should I expect from an investment adviser?

The Commission's intention is to help people use the information that issuers must provide in their investment statements and prospectuses to decide whether or not a particular investment is right for them.

Click [here](#) to visit the website.

Finance companies report compliance

When asked to report to the Securities Commission in August, all but one of 67 finance companies reported that their current prospectuses complied with the law and were not false or misleading.

The only finance company that did not report compliance later went into receivership.

The Securities Commission wrote to all finance companies to remind them of their ongoing obligation to keep their prospectuses and, in particular, the financial information contained in them, up to date. “Investors need the information from finance companies to be up-to-date and accurate, so that they can assess the risks and returns of investments before they make decisions about investing” said acting Chairman, Colin Beyer. “If there has been a material adverse change they must not take any further investment money until the prospectus has been amended”.

The Commission can require a finance company to correct information in its investment statement, prospectus or advertising but it cannot step in to stop a finance company failing, or take action against a finance company that fails.

Where appropriate, the Securities Commission refers possible breaches of securities laws to the Registrar of Companies to consider prosecution.

New business portal launched

A new government website designed to promote good business practices and to make it easier for New Zealand companies to do business has been launched.

The website, www.business.govt.nz, provides free access to a range of independent resources aimed at helping small and medium-sized businesses, and the people that advise and support them.

The site includes practical resources and links to information to help start, manage and grow businesses and to deal with day-to-day challenges.

Click [here](#) to visit the site.

Independent audit regulation and oversight in New Zealand

The Minister of Commerce agreed that a letter sent from the Securities Commission and the big four accounting firms asking for priority to be given to the discussion paper on audit regulation should be published.

The major points of the letter are:

- New Zealand does not have an independent audit oversight structure and is lagging behind other jurisdictions in this regard.
- The Ministry of Economic Development's planned discussion paper on audit regulation and oversight has been put on hold with no new start date.
- The current audit oversight regime (run by the New Zealand Institute of Chartered Accountants) lacks independence and objectivity, and does not have the capability and credibility to engage with other regulators and participate in international regulator forums.
- The chief executive officers of the International Audit Networks recognise that independent audit oversight regimes reinforce the independence of auditors and believe that it improves the governance and regulation of the auditing profession.
- The chief executive officers of the International Audit Networks have requested that audit regulation be more globally coordinated. However, New Zealand cannot participate in this process if we do not have an independent audit regulation and oversight regime.
- New Zealand has no legislative provisions dealing with auditor liability. Given the move to trans-Tasman mutual recognition of securities, it would make sense to instigate similar audit regulation frameworks within New Zealand and Australia.

New PPSR website

A new look Personal Property Securities Register website is scheduled for launch later this year.

The Ministry of Economic Development is promising the new site will add value to the New Zealand business community by better serving the consumer sector and providing clear and up-to-date information to all.

The website address will remain www.ppsr.govt.nz and no changes will be made to any of the on-line processes available on the site.

BELL GULLY NEWS

Bell Gully retains place in global top tier rankings

Bell Gully has retained its top rankings in the 2008 edition of IFLR1000, a guide to the world's leading financial law firms.

Partners talk finance law reform across Tasman

The implications for Australian-based business of the significant reform of New Zealand's finance sector law was on the agenda at a Sydney seminar in August.

Progress by partnership makes sense

Using private sector money and expertise to build and operate public buildings like schools and hospitals can deliver real benefits, argues Hugh Kettle.

For further details and more news visit www.bellgully.com

USEFUL WEB LINKS

New Zealand Government

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

New Zealand financial agencies and organisations

- Commerce Commission [www.comcom.govt.nz]
- The Companies Office [www.companies.govt.nz]
- Export Credit Office [www.treasury.govt.nz/exportcreditoffice]
- NZ Law Commission [www.lawcom.govt.nz]
- Office of the Banking Ombudsman [www.bankombudsman.org.nz]
- Office of Insurance and Savings Ombudsman [www.iombudsman.org.nz]
- Office of the Privacy Commissioner [www.privacy.org.nz]
- Personal Property Securities Register [www.ppsr.govt.nz]
- Reserve Bank of New Zealand [www.rbnz.govt.nz]
- Securities Commission [www.sec-com.govt.nz]
- Takeovers Panel [www.takeovers.govt.nz]

New Zealand commercial sites

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

Australian Government sites

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

Australian commercial 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]

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