

**BELL GULLY**



# Financial Services Quarterly

---

SUMMER 2008

---



**Welcome to the Summer 2008 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:

In the courts  
Legislation/In Parliament  
Recent developments  
Bell Gully news  
Useful Web links

**In this issue...**

- **Emissions Units Bill - more than meets the eye**
- **A lesson for suppliers of goods**
- **Guarantor allowed to set-off amount owed by creditor to debtor**

**Need more information?**

For more information on any of the cases, articles and features in *Financial Services Quarterly*, please email [rachel.gowing@bellgully.com](mailto:rachel.gowing@bellgully.com) or call on 64 9 916 8825.

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

## In the courts

### **A lesson for suppliers of goods**

In this case, wool was supplied to Feltex shortly before it went into receivership. The terms of the supply agreement were that supplies were only to be made following receipt of payment, but the supplier mistakenly made the supply before payment was received.

### **Guarantor allowed to set-off amount owed by creditor to debtor**

This case outlines the general principle that, in the absence of anything to the contrary, a guarantor may take advantage of any set-off or counterclaim that the principal debtor has against the creditor.

### **Consent of guarantor implied when he agreed a variation as director**

When a sole director and shareholder agreed a variation on the company's behalf, his consent as personal guarantor was implied.

### **Register your security interests or be prepared to lose priority**

When a lessor failed to register its security interest on the Personal Property Securities Register, it had to relinquish amounts collected by it to the holder of a registered general security agreement.

### **An agreement to give a guarantee can be a guarantee**

When an individual signed a letter including an agreement to give a personal guarantee, the court decided that he was liable.

### **Failure to read a document does not absolve a guarantor's liability**

An argument by two individuals that they had failed to read a document they signed and did not realise that it contained a guarantee was rejected by the High Court.

### **Guarantee unlimited notwithstanding credit limit, and joint and several though not specifically stated**

A guarantee of all amounts owing was found to be unlimited notwithstanding a credit limit imposed in respect of the underlying credit. In addition, although the guarantee was not specifically stated to be joint and several, it was found to be.

### **Claim of breach of fiduciary duty unsuccessful**

The High Court ruled against a woman who claimed breach of fiduciary duty by a solicitor because he acted for both her and her husband, who she claimed forced her to sign a guarantee against her will.

## Legislation/In Parliament

### **Emissions Units Bill - more than meets the eye**

Hot on the heels of the package of financial services legislation introduced by the Government at the end of last year comes the draft Emissions Units Settlement Systems and Futures Bill.

### **Securities Commission to call for disclosure statements of investment advisers and investment brokers**

The Securities Commission has announced its intention to contact investment advisers and brokers to check their compliance with new investment adviser disclosure laws that were passed in October 2006.

### **Financial Advisers Bill first reading**

Commerce Minister Lianne Dalziel has moved that the Financial Advisers Bill be read for the first time.

### **Limited Partnerships Bill – still room for improvement**

Proposed changes to the Bill establishing limited partnerships in New Zealand will make the structure more appealing to investors but, as Bell Gully partner Andrew Abernethy points out in this article, there are still some key issues to be sorted.

## Recent developments

### **Securities Commission completes Cycle 6 of Financial Reporting Surveillance Programme**

The commission reviewed financial reports of 30 issuers with balance dates from 31 December 2006 to 30 April 2007, reporting that few matters were identified in the review.

### **Finance company ordered to refund 1200 customers**

A finance company has agreed to refund 1200 customers after they were charged an unreasonable early repayment fee.

### **Four New Zealand banks accredited under Basel II Accord**

The Reserve Bank of New Zealand has accredited four New Zealand banks to adopt the internal models approach under the Basel II banking supervisory regime.

### **Changes to Companies Office filing by liquidators and receivers**

The Companies Office is introducing changes that will impact the way that liquidators, receivers and company administrators file reports with the Companies Office.

### **Financial Reporting Act Class Exemptions for Australian and United States incorporated companies**

In 2006 a new power was given to the Registrar of Companies to exempt certain overseas companies from compliance with various provisions of the Financial Reporting Act as part of the Government's programme to improve the workability of the financial reporting system and reduce business compliance. In this note Bell Gully partner Glenn Joblin and solicitor Ryan Ellis provide an overview of the two class exemptions issued by the Registrar of Companies since the new provisions came into effect.

### **Final changes arising from Securities Legislation Bill in force on 29 February**

The last of the changes made by the 2006 Securities Legislation Bill came into effect on 29 February. In this note we provide you with a brief outline of the final key components of the Government's securities reform package which are now in place.

### **Privacy in the online world**

Debate has been ignited over what exactly constitutes personal information amid growing concern about online privacy. In this article senior associate Heidi Leslie looks at the European debate and why it triggers a reminder for New Zealand business.

## In the courts

### A lesson for suppliers of goods

*In this case<sup>1</sup>, wool was supplied to Feltex shortly before it went into receivership. The terms of the supply agreement were that supplies were only to be made following receipt of payment, but the supplier mistakenly made the supply before payment was received.*

When Feltex went into receivership, the supplier argued that continued retention of the wool amounted to conversion. The receivers argued that the supply agreement was a conditional sale agreement within the meaning of the definition of "security interest" in the Personal Property Securities Act 1999 (the PPSA).

The High Court agreed with the receivers, concluding that the supply agreement was in fact a conditional sale agreement that created a security interest under the PPSA. Rejecting the supplier's claim that a conversion had occurred, the court pointed out that possession of the wool was voluntarily transferred by the supplier.

The supplier's failure to register its security interest in the wool within the time frame required under the PPSA to achieve a purchase money security interest resulted in the supplier losing priority in the wool to ANZ National Bank, which had a first registered general security agreement.

---

<sup>1</sup> *JS Brooksbank & Co. (Australasia) Limited v EXFTX Limited (in receivership and liquidation)*, High Court, 21 November 2007

## **Guarantor allowed to set-off amount owed by creditor to debtor**

*This case<sup>1</sup> outlines the general principle that, in the absence of anything to the contrary, a guarantor may take advantage of any set-off or counterclaim that the principal debtor has against the creditor.*

Two companies had a trading arrangement. The obligations of one of the companies to the other was guaranteed. The guarantee was of:

"the due and punctual payment by [company A] to [company B] in the manner and at times agreed upon ... of all moneys which are now or may hereafter from time to time be owing by [company A] to [company B]".

Summary judgment was entered against the guarantor and the guarantor brought this case, arguing that the company whose obligations he had guaranteed had been overcharged by the other company.

The High Court determined that in order to establish a claim against the guarantor, it must be proved that the moneys are owing. Any defence that might be available to resist a claim for the amount owing must also be available to the guarantor.

The appeal against the summary judgment was allowed.

---

<sup>1</sup> *Ryan v Acme Supplies Limited*, High Court, Wellington, CIV 2007-485-1096

## **Consent of guarantor implied when he agreed a variation as director**

*When a sole director and shareholder agreed a variation on the company's behalf, his consent as personal guarantor was implied.*

In this case<sup>1</sup>, a company advanced two loans to another company, which gave second and third mortgages as security. The sole director and shareholder of the borrower personally guaranteed the loans.

The guarantor subsequently sold the security property, and the first mortgage was discharged. The guarantor's understanding was that the price reflected the amounts owing under the outstanding loans and that the purchaser would repay them, discharging the second and third mortgages. The purchaser argued that it had not agreed to take over the loans.

When the lender demanded repayment of its loans, the borrower went into liquidation and the lender pursued the guarantor for payment.

The District Court determined that the main issue was whether it was agreed that the purchaser would take over the loans, and decided in the lender's favour that it was not.

The High Court considered whether variations to the principal contract (including release of the unregistered second and third mortgages, transfer of the security property to the purchaser and extending the date for repayment of the loans) effectively discharged the guarantor's liability.

The guarantor had clearly agreed to the variations, but in his capacity as director and shareholder of the borrower. The decision was that, while the roles of director and guarantor are legally distinct, consent to the variation could be implied from the guarantor's knowledge of, and involvement in, the transaction.

---

<sup>1</sup> *Liguori v Richelieu Investments Limited*, High Court, Auckland, CIV 2007-404-492, 2 November 2007

## Register your security interests or be prepared to lose priority

*When a lessor failed to register its security interest on the Personal Property Securities Register, it had to relinquish amounts collected by it to the holder of a registered general security agreement.*

In this case<sup>1</sup>, money was loaned to a company in return for a security interest over all present and after-acquired property of the borrower. The security interest was registered by the lender on the Personal Property Securities Register (PPSR).

The borrower also leased machinery from a lessor, who collected accounts receivable on behalf of the borrower. The security interest in the machinery was not registered on the PPSR.

When the borrower defaulted on payments to the lender, the lender appointed receivers. The receivers contended that the amounts collected by the lessor were secured by the general security agreement and should accordingly be turned over to the receivers.

The court determined that:

- the lender did have a security interest in the accounts receivable under the general security agreement;
- and
- the lessor may have a security interest in the accounts receivable under the lease.

The issue of priority was easy to determine because the lender had registered its interest and the lessor had not.

---

<sup>1</sup> *Richard Grant Simpson and Traveor Francis Thornton as receivers of Dryland Contracting Limited (in receivership) v Reymar Contracting Limited*, High Court, Hamilton, CIV 2007-419-443, 7 December 2007

## **An agreement to give a guarantee can be a guarantee**

*Where an individual signed a letter including an agreement to give a personal guarantee, the court decided that he was liable.*

This case<sup>1</sup> started with a dispute about an amount owing by a property development company to an earth works contractor. The parties ended up signing a deed detailing how the dispute would be settled, but payments due under the deed fell into arrears. Following a meeting between the parties, the contractor wrote to the developer setting out payment arrangements and including a statement that personal guarantees were required from the property developer and his wife.

The developer made some hand-written amendments to the letter, signed it and returned it to the contractor. The letter included the words "we the undersigned agree to the repayment proposal above and give our personal guarantees".

The developer also sent a separate letter to the contractor stating that some of the arrangements set out in the first letter were unacceptable and that, while his wife was not able to give a personal guarantee, he was prepared to offer one.

A statutory demand was subsequently issued by the contractor and the property development company went into voluntary liquidation.

The issue for consideration by the High Court was whether or not the property developer guaranteed the company's debt to the contractor. The court decided that there was no question of fact in this case and that the developer's signing of the letter including the words "we the undersigned agree to the repayment proposal above and give our personal guarantees" meant that the developer did not have a defence to the contractor's claim.

---

<sup>1</sup> *Wharehine Construction Limited v Simon Buxton*, High Court, CIV 2006-404-3198, 4 December 2007

## **Failure to read a document does not absolve a guarantor's liability**

*An argument by two individuals that they had failed to read a document they signed and did not realise that it contained a guarantee was rejected by the High Court.*

This case<sup>1</sup> involved two directors of a company that was supplied electrical goods under a written supply contract. When the company was placed into voluntary liquidation, the supplier claimed the amount outstanding from the directors under a guarantee contained in the supply contract.

The directors argued, using the *non est factum* defence, that they were unaware of the guarantee in the contract because they did not read it.

The court found that the directors were liable because they were careless in failing to read the document before they signed it. In any event, in the signature block where the document stated "please print name of Guarantor", they entered their names.

The onus is on the person who signed the document to prove they acted carefully, not on the other party to prove the contrary.

---

<sup>1</sup> *Rexel Limited trading as Rexel Electrical Supplies New Zealand Limited v AJ Linstrom, SG Bryant and SB Williams*, High Court, Auckland, CIV 2006-404-7534, 7 December 2007

## **Guarantee unlimited notwithstanding credit limit, and joint and several though not specifically stated**

*A guarantee of all amounts owing was found to be unlimited notwithstanding a credit limit imposed in respect of the underlying credit. In addition, although the guarantee was not specifically stated to be joint and several, it was found to be.*

This case<sup>1</sup> arose when a supplier of goods sued a guarantor for amounts owing under a supply contract. The principals of the company that the goods were supplied to both signed as guarantors. When the company failed to pay the amounts owing, judgment was entered against one of the guarantors for the full amount outstanding.

The guarantor appealed the decision, arguing that:

- his liability was limited to one half of the amount outstanding; and
- his liability was limited to \$10,000, being the extent of the credit limit imposed by the supplier.

The Court of Appeal found that while the document did not specifically record that the guarantee was joint and several, it was an “unconditional guarantee”, a “continuing guarantee”, a “guarantee of all amounts owing”, and the guarantors acknowledged their liability as principal debtor. All of these were determining factors in the court’s finding that the guarantee was joint and several.

The Court of Appeal also found that the guarantee was not limited to \$10,000 because the document referred to it unconditionally guaranteeing “the due payment of all amounts owing ... from time to time at any time” and included confirmation that liability would not be affected by a “variation in terms of supply”.

---

<sup>1</sup> *Jack Malcolm Moulder v Checkpoint Meto Limited*, High Court, Napier, CIV 2007-441-0578, 27 November 2007

## Claim of breach of fiduciary duty unsuccessful

*The High Court ruled against a woman who claimed breach of fiduciary duty by a solicitor because he acted for both her and her husband, who she claimed forced her to sign a guarantee against her will.*

In this case<sup>1</sup>, a loan was made to a company, and guaranteed by a husband and wife. Both the husband and wife were advised by the same solicitor when they signed the guarantee. When the company defaulted on the loan and the lender obtained judgment against the husband and wife pursuant to the guarantee, the wife claimed that her husband forced her to sign it, using physical violence, verbal abuse and threats.

The wife alleged that the solicitor was aware that her husband was forcing her to sign the guarantee, that this was a conflict of interest and that, accordingly, he breached his fiduciary duty to her.

The High Court determined that:

- although the solicitor did not obtain the wife's informed consent before acting for both guarantors, this did not cause any loss because she still would have signed the guarantee;
- it was unlikely that somebody of the solicitor's experience and unblemished record would have proceeded to witness the wife's signature if he believed there was any pressure from her husband to sign it; and
- it would not have accepted an alternative submission that the guarantee was unenforceable because the lender was on notice of potential undue influence because the solicitor's certificate showed that the guarantors were not independently advised.

---

<sup>1</sup> *Rawleigh v Tait*, High Court, Wellington, CIV 2003-485-1924

## Legislation/In Parliament

### Emissions Units Bill - more than meets the eye

*Hot on the heels of the package of financial services legislation introduced by the Government at the end of last year (covered in a previous FSQ Bulletin) comes the draft Emissions Units Settlement Systems and Futures Bill.*

But don't let the title of the draft Emissions Units Settlement Systems and Futures Bill (the Bill) mislead you. While the principal purpose of the Bill is to facilitate the trading of emissions units in New Zealand, significant parts of the Bill introduce legislation that will affect financial markets participants generally.

This note outlines both the specific rules proposed for emissions units and the general rules proposed for the broader financial markets.

#### Specific rules for emissions units

The Bill proposes to introduce a series of technical rules that, broadly, have the effect of treating a new class of asset (emission units) like an existing one (company shares). For example, the Bill replicates for emissions units provisions dealing with the registration of, and transfer of title to, shares. The Bill also extends to emissions units a provision in the Personal Property Securities Act 1999 (the PPSA) that gives priority to purchasers of "investment securities".

This parallel treatment approach should be welcomed by banks and others who may be financing the purchase of these units or taking security over them. Such persons will not need to become familiar with an entirely new regime governing title to, and security over, these assets.

The Bill also states that emissions units are "futures contracts" for the purposes of the Securities Markets Act 1988. The effect of this is that those entities who carry on the business of "dealing" in emissions units will require Securities Commission authorisation to do so.

#### General rules for financial markets

These general rules relate to three areas:

- the regulation of futures markets;
- the regulation of "designated settlement systems"; and
- the priority of clearing house collateral.

##### *Futures markets*

Currently, there are separate regimes under the Securities Markets Act governing the regulation of securities exchanges and futures exchanges. Given the small size of the market and the limited number of likely candidates to operate a securities or futures exchange, this structure is seen as unnecessarily duplicative and costly for an entity wanting to operate both types of exchange.

The intention is, therefore, to merge the two regimes and allow a securities exchange to be registered either for the trading of securities only or for the trading of both securities and futures.

##### *Designated settlement systems*

Currently, Part 5C of the Reserve Bank of New Zealand Act 1989 regulates "designated payment systems", of which there are two - CLS Bank International and the Reserve Bank's Exchange Settlement Account System. Designation of a payment system confers a number of statutory protections, designed to ensure the stability of the system if a participant becomes insolvent.

There is currently no equivalent regime for a *settlement* system (such as a clearing house). Therefore, in theory at least, a settlement system is more vulnerable to the failure of one of its participants than is a designated payment system.

The Bill aims to correct this anomaly by extending Part 5C to cover settlement systems. The fundamental protections provided by Part 5C will remain unchanged, but the Securities Commission will join the Reserve Bank in the joint regulation of this regime.

#### *Clearing house collateral*

From a bank's perspective at least, this is probably the most interesting part of the Bill. What is proposed here is that collateral posted by a member of a designated settlement system in favour of the system operator should have a "super priority". That is, it should trump the interests of all other parties in that same collateral. Again, the policy behind this proposal is the need to ensure the stability of the system in the insolvency of a member.

What this will mean in practice for banks and others who deal with clearing house members is that they can never safely assume they have first-ranking security over the cash or securities of the member (cash and securities being the most likely clearing house collateral). In some cases, this may require banks to re-price the risk those entities represent.

#### **Submissions**

The MED called for submissions on the Bill, which are due by 10 March.

## **Securities Commission to call for disclosure statements of investment advisers and investment brokers**

*The Securities Commission has announced its intention to contact investment advisers and brokers to check their compliance with new investment adviser disclosure laws that were passed in October 2006.*

From 29 February 2008 advisers' and brokers' disclosure statements must comply with the new disclosure laws. The Commission's Director of Primary Markets, Kathryn Rogers, has said "we expect advisers and brokers to comply with the law as soon as it takes effect... Investment advisers and brokers have had plenty of time to prepare new disclosure statements".

Ms Rogers has indicated "We first want to know whether each adviser and broker has a disclosure statement as required by the new laws. We will then review a sample of disclosure statements and advertisements for compliance with the new laws. The Commission will take enforcement action in appropriate cases".

The Commission can take enforcement action against advisers and brokers:

- who do not have a disclosure statement;
- whose disclosure statement does not contain the required information; or
- whose disclosure statement or advertising is deceptive, misleading or confusing.

The Commission has power to take actions, including orders to prohibit or correct a disclosure statement, or to disclose information or to temporarily ban an adviser or broker.

The following are criminal offences carrying fines ranging from \$30,000 to \$300,000:

- to not disclose information that the adviser or broker knows should be disclosed;
- to have a misleading, deceptive or confusing disclosure statement or advertisement; and
- to contravene an order made by the Commission.

## Financial Advisers Bill - first reading

*Commerce Minister Lianne Dalziel has moved that the Financial Advisers Bill be read for the first time.*

The intention of the Bill is:

- to foster consumer confidence in those who hold themselves out to be financial advisers; and
- to ensure that those who claim to be professionals in this area are held accountable for their performance, integrity and competence.

Ms Dalziel intends to move that the Bill be considered by the Finance and Expenditure Committee and that the committee reports to the House on or before 20 June 2008.

[Click here](#) to view a copy of the first reading speech.

## Limited Partnerships Bill – still room for improvement

*Proposed changes to the Bill establishing limited partnerships in New Zealand will make the structure more appealing to investors but, as Bell Gully partner Andrew Abernethy points out in this article, there are still some key issues to be sorted.*

In December 2007, the Commerce Select Committee reported back to Parliament on the Limited Partnerships Bill introduced in August to establish a new regulatory and tax regime for New Zealand for limited partnerships - the internationally preferred legal structure for investing in venture capital.

### **The Commerce Select Committee's key changes**

The committee has recommended several changes, which improve the attractiveness of New Zealand limited partnerships as an alternative investment vehicle. Key changes include:

#### *Contracting out obligations*

The fiduciary obligations of a general partner to the limited partners may now be contracted out of through the relevant limited partnership agreement. A new clause also provides that a limited partner does not have any fiduciary obligations to the limited partnership or to any other partner. While fiduciary principles may have their place in contractual dealings, they are not ideal as mandatory principles for participants in limited partnerships. It is encouraging to see that these principles are now "default" rules, which may be contracted out of by relevant partners. The overseas experience has been that mandatory inclusion of fiduciary principles into a structure such as the limited partnership creates operational uncertainties and inefficiencies.

#### *Information disclosure*

The select committee has also proposed a change in requirements around the provision of limited partnership information. While certain information regarding limited partners must be provided to the Registrar of Companies, it is now not to be made available to members of the public (and is not to be subject to Official Information Act requests). The disclosure of limited partnership information, in some jurisdictions, goes beyond basic information and into details of capital commitments. Given that limited partners are not responsible for the debts of the partnership, other than for unpaid capital, details of the identity of the partners rarely provides useful information to members of the public (and is often sensitive).

#### *Business restrictions*

Restrictions on limited partnerships engaging in banking and insurance or on listing on securities markets have been deleted from the Bill. The place for these restrictions is in industry-specific regulation (such as banking and insurance legislation or in stock exchange listing rules) rather than an entity-type regulation. There is nothing in the nature of a limited partnership that makes it more or less suitable for listing on the stock exchange, for example, than any other sort of entity.

### **Remaining areas for improvement**

While the amendments are an improvement, there are still several areas where the Bill could be significantly improved.

#### *Control rule*

The so-called "control rule", which provides that limited partners are responsible for the debts of the limited partnership if they engage in "control type" activities, is not a good idea even when it is coupled, as anticipated, with a long list of authorised "safe harbour" activities. The Commerce Committee has recommended only that the list of safe harbours be moved from regulations to be made under the Act into the body of the Act itself.

The "control rule" creates uncertainty around limited partners exercising veto, voting and other control rights over the management and operation of the limited partnership and therefore requires elaborate and often exhaustive lists of permitted activities. The rule has led, in its application, to uncertainty and costs for market participants in the administration of limited partnerships worldwide.

A better approach has been adopted by the National Conference of Commissioners on Uniform State Laws in the United States. It does away with the control rule altogether and provides that limited partners are not liable for the obligations of the partnership even if they do engage in the management and control of the limited partnership. The National Conference of Commissioners adopted this principle because it believed that the control rule had become an anachronism in a world with limited partnerships, limited liability companies and other flow through entities and that eliminating the control rule would allow for the "next logical step in the evolution of the limited partnership".

In its submission, Bell Gully recommended that the draft Bill be amended to remove the control rule and with it the need to draft (and continue to keep updated in line with international jurisdictions) the list of safe harbours.

#### *Limited partnership agreement*

The Bill has moved from requiring that limited partnerships have a limited partnership agreement to requiring that the limited partnership agreement itself covers certain specified matters. To save time, litigation costs and uncertainty for participants, it would be preferable to create a default set of rules that apply in the absence of agreement to the contrary.

Given the sophisticated nature of participants who are likely to use limited partnerships, almost all limited partnerships established will have detailed limited partnership agreements. Even so, we do not consider that it is good use of public funds to have courts dealing with situations in which the partners to a limited partnership have not addressed a matter that could have been dealt with in default rules.

#### *Taxation of capital gains*

One of the principal benefits of limited partnership structures internationally is the ability to compensate the general partner through its "carried interest" profit participation. A key element of this is that the character of the partnership gains (i.e., capital gains or ordinary income) are preserved in the hands of all partners (whether limited partners or general partners). In theory, this allows a general partner to receive a "performance fee" as a non-taxable capital gain (and on which no value added or sales tax) would be assessable.

However, under New Zealand income tax law, partnership gains derived from realisations of portfolio securities will, where those securities are held on revenue account, be taxed at marginal income tax rates, to all partners – thereby making the structure less attractive in some respects than a "portfolio investment entity" which pays no tax on sales of New Zealand (and some Australian) equity securities.

#### **Next steps**

The Bill is currently awaiting its second reading in Parliament. If it passes into law as planned, the Bill will come into force on 1 April 2008. In the meantime, regulations (provided for in the Bill) will need to be enacted before the Bill comes into force. We will keep you informed of any further developments.

For further information on the Bill contact [Andrew Abernethy](#) or your usual Bell Gully adviser.

To access a copy of the Select Committee's Report on the Limited Partnerships Bill visit Parliament's website [www.parliament.nz](http://www.parliament.nz) or [click here](#).

To access a copy of the consultation document for the Limited Partnerships Bill: Safe Harbours and Fees Regulations visit the Ministry of Economic Development's website [www.med.govt.nz](http://www.med.govt.nz) or [click here](#).

## Recent developments

### **Securities Commission completes Cycle 6 of Financial Reporting Surveillance Programme**

*The Securities Commission has reviewed financial reports of 30 issuers with balance dates from 31 December 2006 to 30 April 2007, reporting that few matters were identified in the review.*

The Commission reports that it is "encouraged by the commitment of the issuers and their auditors to comply with NZ GAAP and to provide a true and fair view of their state of affairs". Compliance with NZ GAAP is described as "good, however, there is still room for improvement".

The Commission intends to continue its financial reporting surveillance programme, and to take appropriate steps to encourage compliance with Financial Reporting Standards and other aspects of NZ GAAP.

For a copy of the report on Review of Financial Reporting by Issuers Cycle 6, go to [www.seccom.govt.nz](http://www.seccom.govt.nz)

## **Finance company ordered to refund 1200 customers**

*A finance company has agreed to refund 1200 customers after they were charged an unreasonable early repayment fee.*

The affected customers were charged an early repayment fee that equated to 31 days interest on the outstanding balances of their loans at the time of full prepayment.

The finance company admitted that this breached the Credit Contracts and Consumer Finance Act 2003 (the Act), which prohibits prepayment fees from exceeding a reasonable estimate of the creditor's loss caused by the early repayment.

Commerce Commission Chair Paula Rebstock said "the issue of reasonableness of credit fees is a strategic priority for the Commission. The Commission does not accept that a creditor can impose an arbitrary charge on consumers who repay their loans early. The Act is clear that credit fees applied to consumer credit contracts must be reasonable."

The Commission has issued warning letters to other creditors whose formulae were not appropriate procedures for the calculation of the creditors' loss arising from full pre-payment under the Act.

## **Four New Zealand banks accredited under Basel II Accord**

*The Reserve Bank of New Zealand has accredited four New Zealand banks to adopt the internal models approach under the Basel II banking supervisory regime.*

The banks who have been accredited to use the internal models for credit and operational risk from the first quarter of 2008, are:

- ANZ National Bank Limited;
- ASB Bank Limited; and
- Westpac New Zealand Limited.

In addition, Bank of New Zealand has been accredited to use internal models for operational risk from the first quarter of 2008. Bank of New Zealand is expected to apply for accreditation of its credit risk models during the year.

Reserve Bank Deputy Governor Grant Spencer said that "a key feature of the Basel II regime is that it increases the sensitivity of capital requirements to key bank risks, particularly credit risk".

## **Changes to Companies Office filing by liquidators and receivers**

*The Companies Office is introducing changes that will impact the way that liquidators, receivers and company administrators file reports with the Companies Office.*

From 1 July 2008, the Companies Office will only accept reports filed using what's known as the *online administration, receivership and liquidation management tool*. The online tool provides liquidators and receivers with access to all of their administrations as well as on-screen information displaying what reports are due for each. In addition, reports can be uploaded directly to the Companies Office using this tool.

The Companies Office will be holding a series of free one hour liquidation, receivership and voluntary administration workshops.

[Click here](#) for more information.

# Financial Reporting Act Class Exemptions for Australian and United States incorporated companies

*In 2006, a new power was given to the Registrar of Companies to exempt certain overseas companies from compliance with various provisions of the Financial Reporting Act as part of the Government's programme to improve the workability of the financial reporting system and reduce business compliance. In this note, Bell Gully partner Glenn Joblin and solicitor Ryan Ellis provide an overview of the two class exemptions issued by the Registrar of Companies since the new provisions came into effect.*

## Financial reporting obligations

Under the Financial Reporting Act 1993 (FRA), all overseas incorporated companies carrying on business in New Zealand are required to prepare financial statements that comply with the FRA. Those financial statements comprise:

- financial statements in respect of the entire activities of the overseas company;
- consolidated group financial statements (if the company has any subsidiaries); and
- financial statements solely in respect of the activities of the overseas company's New Zealand business.

The requirements under (a) and (b) above are often onerous as many overseas companies that are part of a group of companies are not required to prepare financial statements under the laws of the country in which they are incorporated.

Following the 2006 amendments to the FRA, the Registrar of Companies may exempt the directors of an overseas company from compliance with various provisions of the FRA. The Registrar cannot grant exemptions for any overseas company that is an "issuer" under the FRA (eg. listed entities), although an issuer may apply to the Securities Commission for an exemption under the FRA.

The Registrar of Companies has recently issued two class exemptions and a specific exemption for a particular entity.

## Class exemptions

The following class exemptions have been issued:

- (a) the Financial Reporting Act (Overseas Incorporated Companies – United States of America) Exemption Notice 2007; and
- (b) the Financial Reporting Act (Overseas Incorporated Companies – Australian Wholly-Owned Entities) Exemption Notice 2007.

The effect of these class exemptions is that Australian and United States incorporated companies carrying on business in New Zealand may be exempted from certain financial reporting obligations under the FRA.

## United States overseas companies class exemption

The effect of this class exemption is to allow overseas companies incorporated in the United States to provide the group financial statements that they are required to prepare under financial reporting requirements in the United States.

Overseas companies relying on the class exemption will be required to:

- prepare and register financial statements for their New Zealand business and consolidated financial statements only (not stand-alone company financial statements);
- ensure that the consolidated financial statements comply with generally accepted accounting principles in the United States (rather than generally accepted accounting practice in New Zealand); and

- have those consolidated financial statements audited in accordance with the requirements set out in United States legislation and the auditor's report will provide the information required by United States legislation.

For United States incorporated companies to gain the benefit of the class exemption, the consolidated financial statements that are to be filed in New Zealand must be accompanied by a report by an approved auditor that complies with the requirements of Part 210 of the Code of Federal Regulations (US).

To access a copy of this class exemption, visit the Government's legislation website [www.legislation.govt.nz](http://www.legislation.govt.nz) or [click here](#).

### **Australian overseas companies class exemption**

The effect of this class exemption is to allow overseas companies incorporated in Australia, which are wholly-owned subsidiaries that have been granted relief under the Australian Securities and Investment Commission's Class Order [98/1418] Wholly-owned entities, to file consolidated financial statements for the parent entity only that are required to be prepared in accordance with the Class Order.

Exempted companies will not be required to prepare stand-alone financial statements, although they will remain obliged to prepare, and file with the Companies Office, financial statements for their New Zealand business.

The exemptions are subject to the following conditions:

- the consolidated financial statements prepared in accordance with the Class Order must comply with generally accepted accounting principles in Australia and include any additional information and explanations that are necessary to ensure that those financial statements give a true and fair view of the matters to which they relate; and
- the following documents must be delivered to the Companies Office:
  - (i) a copy of those consolidated financial statements;
  - (ii) a memorandum signed by the directors of the overseas company providing various confirmations relating to those consolidated financial statements and the relief granted under the Class Order; and
  - (iii) a copy of the deed of cross guarantee entered into by the overseas company in accordance with the Class Order.

To access a copy of this class exemption visit the Government's legislation website [www.legislation.govt.nz](http://www.legislation.govt.nz)

# Final changes arising from Securities Legislation Bill in force on 29 February

*The last of the changes made by the 2006 Securities Legislation Bill came into effect on 29 February. In this note, we provide you with a brief outline of the final key components of the Government's securities reform package which are now in place.*

## 1. Background

The Securities Legislation Bill, which was passed in October 2006, represents the completion of part three of the Government's four part securities and financial market reform programme. Earlier reforms saw the introduction of the Takeovers Code in 2001 and an overhaul of regulations governing the stock exchange and listed issuers in 2002. The fourth and final part of the securities reform programme is currently underway as part of the Government's Review of Financial Products and Providers. This addresses issues relating to securities offerings under the Securities Act 1978.

The Securities Legislation Bill was passed as:

- the Securities Amendment Act 2006;
- the Securities Markets Amendment Act 2006;
- the Takeovers Amendment Act 2006; and
- the Fair Trading Amendment Act 2006.

Most of the Securities Act amendments and Takeovers Act amendments came into effect after their assent on 24 October 2006. However, several key components of the new securities law were kept on hold pending the approval of regulations. These were the Securities Markets (Substantial Security Holders) Regulations 2007, the Securities Markets (Market Manipulation) Regulations 2007 and the Securities Markets (Investment Advisers and Brokers) Regulations 2007, which were enacted by Order in Council on 3 December 2007. The regulations and the remaining provisions of the Amendment Acts noted above all came into effect on 29 February 2008.

For a complete overview of all the changes made by the Securities Legislation Bill see Bell Gully's earlier article "[Securities Legislation Bill completes the parliamentary process](#)" in the Spring 2006 issue of *Commercial Quarterly*.

## Latest changes in force

The latest key components to take effect include:

- **new disclosure requirements for investment advisers and brokers**

A new part 4 of the Securities Markets Act 1998 together with the Securities Markets (Investment Advisers and Brokers) Regulations 2007 provide for additional disclosure obligations on investment advisers and investment brokers prior to giving advice or receiving investment money or property.

- **a new insider trading regime**

The new insider trading provisions in the Securities Markets Amendment Act 2006 reflect a new rationale for the prohibition of insider trading. In particular, under the new law, anyone can be an insider and inside information can come from any source. Formerly, a person was only an "insider" if they received the information directly or indirectly through their relationship with the public issuer.

A comprehensive overview of the new insider trading provisions is available on our website in a paper titled "[The New Insider Trading Laws](#)" presented by Bell Gully senior associate Jenny Cooper to the Securities Legislation and Capital Markets Update conference held in Auckland in September 2007. Also see:

- o the article "[Urgent law change needed to remedy serious flaw in new insider trading rules](#)" by Bell Gully partner and firm chairman Roger Partridge and senior associate Jenny Cooper; and
- o the article "[Insider trading: how effective is a Chinese wall defence?](#)" in the Winter 2007 *Commercial Quarterly* for some insight into how the New Zealand courts may assess the effectiveness of a Chinese Wall defence to an allegation of insider trading.

- **new law on market manipulation**

Dedicated provisions in the Securities Markets Act 1988 prohibiting forms of market manipulation (or market rigging) have been introduced under the new regime. Three new offences are created for manipulating or interfering with the operation of a securities market. The rules are intended to prohibit practices that are considered to impermissibly affect the price of listed securities and distort the operation of the market in listed securities.

- **changes to the substantial security holders' disclosure regime**

The basic features of the substantial security holders' disclosure regime contained in the Securities Markets Act 1988 have not changed under the new law, but the law has been amended to clarify and simplify the situations in which disclosure is required with a view to reduce compliance costs over the medium to long term.

The new Securities Markets (Substantial Security Holders) Regulations 2007 require some changes to the information that needs to be disclosed when releasing a Substantial Security Holder notice to the market. Under the new regulations, there are three types of disclosures of Substantial Security Holdings:

- disclosure of beginning to have substantial holding;
- disclosure of movement of 1% or more in substantial holding or change in nature of relevant interest or both; and
- disclosure of ceasing to have substantial holding.

The Regulations allow NZX to set or change the forms and delivery methods for each of the above event disclosures with the Minister of Commerce's approval. At this stage, it appears that NZX has chosen to use the same forms set out in Schedule 1 of the Regulations. As required by the Regulations, NZX has made the approved forms available on its website.

To access these forms from the NZX's website [click here](#). Note also that under Regulation 4(2)(a) NZX requires these forms to be completed in either word or plain text format and emailed to [announce@nzx.com](mailto:announce@nzx.com).

In addition to the above disclosure notices, the Regulations also specify forms for a public issuer to use when it requires a person to disclose relevant interests to it under section 35 of the Securities Markets Act or disclose information to it under section 35A of the Act.

- **extended liability for the continuous disclosure regime**

The new part 5 of the Securities Markets Act 1988 contains amended remedies for a contravention of the continuous disclosure obligations. The expanded definition of contravene that is provided by part 5 has the ability to capture senior management who are involved in a contravention by a public issuer of the continuous disclosure obligations. For further details on this topic please refer to our article "[Expanded liability under the continuous disclosure regime](#)" that was published in the Winter 2007 *Commercial Quarterly*.

- **changes to the takeovers regime: truth in takeovers**

The remaining provisions of the Takeovers Amendment Act 2006, which came into force on February 29, introduce market manipulation prohibitions to apply in relation to takeovers. The provisions are broad and cover communications outside the formal offer, target company statement and independent advisers document; with the changes likely to have a significant impact on the way takeovers are run given that many takeovers are won through these communications. For further details on these changes please refer to the article "Truth in takeovers: market participants should prepare for a more rigorous approach" in of the summer 2008 issue of *Commercial Quarterly*.

### **New Securities Law website and Guide**

In 2007, the Securities Commission set up a website ([www.newsecuritieslaw.govt.nz](http://www.newsecuritieslaw.govt.nz)) to help people understand the new securities law. The general scope of the new law is explained on the website and people can register to receive updates as they become available. The website includes a collection of articles and news releases on the new law.

The Securities Commission has also prepared a "[Guide to the New Securities Law 2008](#)" which explains the changes made to the Securities Act 1978 and the Securities Markets Act 1988.

An overview of the new securities law was also published in the Securities Commission's publication, The Bulletin, No 38, January 2007 with a follow up article in The Bulletin No.42, January 2008, which focuses on the Commission's powers to enforce the new rules, penalties and compensation.

## Privacy in the online world

*Debate has been ignited over what exactly constitutes personal information amid growing concern about online privacy. In this article, senior associate Heidi Leslie looks at the European debate and why it triggers a reminder for New Zealand business.*

Privacy in the online world is taking another interesting twist in Europe, fuelled by a call for internet protocol (IP) addresses to become protected information.

But in New Zealand our privacy laws may already afford the protection should a potential breach be questioned.

Each computer is assigned an IP address – a series of specific numbers that can be used to identify it and its user. During hearings into online data protection in the European Parliament last week came a call from the head of the European Union's privacy regulators for IP addresses to be protected as if they were sensitive personal information.

This statement has caused a stir, particularly among search engines such as Yahoo and Google, who typically collect IP addresses to help refine search results – and localise or personalise its online advertisements.

While clearly not everyone believes that IP addresses are personal information, it is a view that is consistent with the spirit of privacy laws around the world: information that can be used to identify individuals should be protected.

Under the New Zealand Privacy Act, "personal information" means information about an identifiable individual. Given that an IP address is unique code assigned to a particular computer and identifiable individuals can then be linked to their computer, it is prudent to treat those IP addresses as personal information for the purposes of the Privacy Act.

Companies and individuals that collect IP addresses should be aware that the obligations of the Privacy Act may apply to IP addresses, just as they do to individuals' names, addresses, phone numbers and other personal details. They ought to comply with the requirements of the Privacy Act when it comes to collecting, storing, protecting and sharing IP addresses or may find themselves on shaking ground in the event of a breach.

In the meantime in Europe the debate continues, with the search engines and other internet organisations touting the possibility of a self-regulatory framework rather than face new laws with potential to have a major impact on online advertising and the search engine business.

*This article was first published in the Dominion Post, 28 January 2008.*

## Bell Gully news

### [Bell Gully tops \*PLC Which Lawyer? 2008\* rankings for New Zealand](#)

Bell Gully has achieved top-tier rankings in six practice areas in *PLC Which Lawyer? 2008*, more than any other New Zealand law firm.

### [Bell Gully appoints new chairman](#)

Bell Gully has elected Roger Partridge as its new chairman. Roger has been a litigation partner since 1992 and has been head of the firm's Litigation Department since 2004. He has served on the firm's Board for seven years.

### [One new partner and five new senior associates in Bell Gully promotions](#)

Bell Gully has promoted six outstanding lawyers to senior roles in the firm from 1 January.

### [Global research places Bell Gully as New Zealand leader](#)

A guide to the world's leading business lawyers has again ranked Bell Gully a clear leader overall among Zealand law firms.

**For further details and more news visit the [news section](#)**

## Useful Web links

### *New Zealand government*

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

### *New Zealand financial agencies and organisations*

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

### *New Zealand commercial sites*

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

### *Australian government sites*

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

### *Australian commercial sites*

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

### *International sites*

- [Bank for International Settlements](http://www.bis.org) [www.bis.org]
- [Global Banking Law Database](http://www.gbld.org) [www.gbld.org]
- [International Monetary Fund](http://www.imf.org) [www.imf.org]
- [International Swaps and Derivatives Association](http://www.isda.org) [www.isda.org]
- [NASDAQ](http://www.nasdaq.com) [www.nasdaq.com]
- [New York Stock Exchange](http://www.nyse.com) [www.nyse.com]
- [United States Securities and Exchange Commission](http://www.sec.gov) [www.sec.gov]
- [World Bank](http://www.worldbank.org) [www.worldbank.org]