

RUSSELL McVEAGH

BANKING LAW UPDATE

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CASES

VOIDABLE TRANSACTIONS

Two recent cases have addressed the voidable transaction provisions of the Companies Act 1993 ("**Act**"): *ANZANI Investments v The Official Assignee* (HC Auckland, CIV 2002-404-1994, 9 May 2007, Courtney J) and *Levin v Market Square Trust* (Court of Appeal, CA224/05, 18 April 2007, Chambers, Randerson, John Hansen JJ).

In *ANZANI Investments*, the Official Assignee, as liquidator of Anzani Settlement Limited ("**ASL**") had asserted that a payment of \$70,000 made five months before the liquidation was voidable under s 292(2) of the Companies Act 1993. Anzani Investments Limited ("**AIL**"), which was the ultimate recipient of the money, applied for an order under s 294(2) of the Act that the transaction not be set aside or alternatively for relief under s 296(3) denying the liquidator recovery of the amount paid.

ASL was a joint venture partner with Settlement Fisherton Limited ("**SFL**"). The joint venture defaulted under certain loans. Mr Kroon, who was a director of both ASL and AIL, claimed to have borrowed \$78,126.08 from AIL and lent it to the joint venture. Five months before the liquidation,

Mr Kroon requested Westpac to pay him \$70,000 from a joint venture account. Mr Kroon subsequently paid the \$70,000 to AIL.

Courtney J found that:

- (a) the payment of \$70,000 from the joint venture account to AIL was a payment by ASL to AIL and was therefore a transaction for the purposes of s 292(1);
- (b) the payment had a preferential effect, resulting in a diminution of the funds available for the general pool of unsecured creditors;
- (c) ASL was clearly unable to pay its debts at the time of the payment and AIL had failed to rebut the presumption raised under s 292(3)(a);
- (d) because of the existence of at least one other debt the payment of the proceeds of sale to one creditor (particularly a related party) was not in the ordinary course of business and AIL had failed to rebut the presumption raised in s 292(3)(b);

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- (e) the evidence was insufficient to show that AIL received the money through Mr Kroon in good faith and there is no evidence that it altered its position in the reasonably held belief that the payment was validly made and would not be set aside. AIL therefore failed to bring itself within s 296(3).

As such, AIL's application was declined.

Levin v Market Square Trust was an appeal by a liquidator against the decision of Associate Judge Sargisson in *Market Square Trust v Levin* (2005) 9 NZCLC 263,935 where it was held that a transaction that was claimed to be voidable by the liquidator was not to be set aside.

One Italy Limited leased business premises from Market Square Trust. One Italy was in arrears with its rent payments. One Italy entered into an agreement to sell its business to Peek Developments Limited, which was conditional on the trust's consent to the assignment of the lease. The trust advised Peek that it would consent provided arrears of \$35,768.74 were paid. Peek paid the arrears, however the sale of One Italy's business to Peek did not proceed. One Italy was subsequently placed into liquidation and One Italy's

liquidator claimed that the payment to the trust by Peek was a voidable transaction by One Italy in terms of s 292 of the Act. The liquidator served on the trust a notice under s 294, but this notice was set aside in the High Court.

The four issues on appeal were:

1. Whether the payment to the trust was a payment by One Italy for the purposes of s 292(1) (Sargisson J in the High Court had found that it was a payment by Peek, and accordingly was not a "transaction" for the purposes of s 292).
2. Whether the payment was made at a time when One Italy was unable to pay its due debts?
3. Did the payment fulfil the criteria of s 292(2)(b)?
4. If so, did the trust receive the money in good faith?

The Court of Appeal found that, while on its face the payment was made by Peek, the payment was made out of One Italy's money. This was because Peek had lent One Italy \$35,768.74 so that the arrears of rent owed by One Italy could be paid. Details of the loan were recorded in

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correspondence between the parties' solicitors and the loan itself was secured under a general security agreement. As such, Peek made the payment "using funds which ... belonged to One Italy as a result of the loan".

In relation to the second issue, the court concluded that the payment was made at a time when One Italy was unable to pay its due debts.

In looking at the third issue, the court addressed two interpretative issues. First, whether the liquidator must prove only that the creditor has likely received more than would otherwise have been the case in liquidation or whether the liquidator must in addition prove that the general body of creditors has been disadvantaged as a result. The court confirmed that the first approach was the correct one. Secondly, the court looked at whether the test for preference under s 292(2)(b) involves a comparison of what the payee has received with what he or she would have obtained in a hypothetical liquidation on the date of the payment, or whether the correct comparison is what the payee is likely to receive in actual liquidation. The court confirmed the latter is the correct interpretation. Having determined these

interpretative issues the Court confirmed that the payment did fulfil the criteria of s 292(2)(b).

Finally, after examining the facts the Court found that the trust did not receive the money in good faith. As such, the appeal was allowed and an order was made under s 295(a) requiring the trust to pay the liquidator the sum of \$35,768.74.

APPOINTMENT OF INTERIM LIQUIDATORS

Registrar of Companies v Nearzero Inc (HC Nelson, CIV-2007-442-240, 16 July 2007, Wild J)

This case addressed an application by Nearzero Inc for rescission of an order appointing interim liquidators. The order was made following an application by the Registrar of Companies for Nearzero to be put into liquidation, on the basis that Nearzero was both unable to pay its debts and that on the facts it was just and equitable to do so.

Nearzero is incorporated in the United States of America and carrying out business activities in New Zealand, although it is not registered in New Zealand as an overseas

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company. Through a series of share purchase meetings Nearzero offered shares to investors to raise funds for its telecommunications technology. Nearzero had not registered an investment statement or prospectus at that time, so the offer was in breach of s 37 of the Securities Act 1978. Investors therefore had the option of having their subscription amounts refunded. Following the appointment of the interim liquidator, Nearzero held a meeting encouraging investors to oppose the application for full liquidation and to withdraw any claims already submitted to the interim liquidators.

Having noted that there were a significant number of investors both in support and opposition to the liquidation (ie, a number of shareholders wished to retain their shares despite the non-compliance with the Securities Act), the High Court adjourned the application for rescission, preferring instead to allow the subscribers themselves to decline to rescind the order appointing the interim liquidators and to elect to either (i) have the subscription monies refunded under s 37(4),(5) and (6) of the Act, for issuing securities in breach of s 37 of the Act, or alternatively (ii) consent to the validation of the allotment under s 37AH of the Act. To this end, the High Court directed the interim liquidator, together

with input from Nearzero, to send an information package to subscribers outlining Nearzero's current financial state and prospects and to seek their election for either (i) or (ii) above. The interim liquidator was to report to the High Court on the outcome of that process at the earliest opportunity.

LEGISLATION

COMMENCEMENT OF SECURITIES MARKETS AMENDMENT ACT 2006

Regulations are being drafted that will bring the Securities Markets Amendment Act 2006 into force. They are expected to be promulgated in October, and will come into effect towards Christmas, allowing for a 2-3 month transitional period. Changes made by the Securities Markets Amendment Act 2006 include:

- amendments to the substantial security holder disclosure regime;
- a new insider trading regime, the key aspect of which is the introduction of a broad prohibition on insider trading (currently an insider is liable to a select group of people if they buy, sell or tip in relation to insider trading);
- new market manipulation laws; and
- a revised regime for regulating investment advisors and brokers based on mandatory disclosure.

CHANGES TO PARTNERSHIP REGIME

The Limited Partnerships Bill was introduced on 7 August 2007. The Bill introduces new regulatory rules for limited partnerships and is intended to make New Zealand more competitive in attracting venture capital investment. The limited partnership structure is commonly used in many other countries for venture capital investment and the changes in the Bill aim to provide similar options for New Zealand organisations wishing to access investment capital.

The Bill introduces a number of tax changes to support the new regulatory rules relating to limited partnerships. Limited partnerships will be taxed in the same way as general partnerships, that is, a limited partnership will not be taxed as a separate legal entity. Rather, each partner will be taxed individually in proportion to his or her share of the partnership income. The new rules also concern the tax consequences of entering and leaving partnerships.

For more information about the tax changes relating to limited partnerships, see www.taxpolicy.govt.nz

Legislation continued ...

ELECTRONIC LODGEMENT OF MORTGAGES AND TRANSFERS

From 1 August 2007 e-dealing is compulsory for lodging standard mortgages and transfers with LINZ. There are a number of exceptions, for example multi-page memoranda incorporating numerous specific clauses and transfers incorporating covenants. It is also possible to apply to LINZ for an exemption.

Instructions on how to use e-dealing can be found at www.landonline.govt.nz

AUSTRALIAN SECURITIES & INVESTMENTS COMMISSION'S PRIORITIES FOR NEXT 12 MONTHS

On 30 May 2007, newly-appointed Australian Securities and Investments Commission ("**ASIC**") chairman Tony D'Aloisio gave a speech to the Senate Standing Committee on Economics outlining six areas ASIC will focus on in the coming 12 months. The six areas are:

- improving the operational effectiveness and service levels of ASIC;

- assisting retail investors, with ASIC setting up a special team to examine and put in place programmes in response to the growth in retail investment and the increasingly sophisticated products being offered;
- insider trading, continuous disclosure and market manipulation of exchange-traded and over-the-counter products (in conjunction with the Australian Securities Exchange);
- reducing administration costs and improving services, particularly for small and medium business;
- facilitating capital flows both into and out of Australia, subject to adequate protection for investors, with the aim of developing local capital markets and providing better access to offshore markets; and
- undertaking a strategic review of ASIC and its direction over the next three to five years, a key feature of the review being the involvement of external stakeholders.

Legislation continued...

These areas will be ASIC's immediate focus with longer term goals arising from the results of the strategic review.

**FINANCIAL REPORTING ACT
(OVERSEAS ISSUERS - UNITED STATES OF AMERICA)
EXEMPTION NOTICE 2007**

This exemption notice came into force on 26 June 2007. It offers exemptions to issuers from requirements to register certain audited financial statements required under the Financial Reporting Act 1993 with the Registrar of Companies. The exemptions in the notice are available to issuers that:

- are incorporated in the United States of America;
- have specified financial statements prepared in respect of it; and
- offer securities to the public in New Zealand only in reliance on either the Securities Act (Overseas Employee Share Purchase Schemes) Exemption Notice 2002 or the Securities Act (Overseas Listed Issuers) Exemption Notice 2002.

The exemptions stated above are conditional on the issuer's statements being compliant with US GAAP and the statements giving a true and fair view of the matters to which they relate.

SNIPPETS

RECENT DEVELOPMENTS IN EUROPEAN LEVERAGE ACQUISITIONS FINANCING

The 2007 *IFLR Supplement: Guide to Mergers & Acquisitions* contains an article by Richard Sharples, of Clifford Chance, entitled **Exciting times**. The article discusses recent developments in terms and structures for European leverage acquisition financing.

The market for leverage acquisition finance has grown in recent years, and continues to do so. The strong structural factors driving the growth have resulted in the rapid development of new products and new combinations of those products. The article takes a deeper look at these changes, and at the key drivers of those changes. It also looks at the resultant products, combinations, and structures that have been seen recently.

The growth in the market has been mainly driven by two factors. First, the large funds now raised by private equity sponsors (\$300 billion globally; giving \$1 trillion of funds for acquisitions when leveraged). Secondly, the size of the subordinated debt market has grown with CLOs, CDOs, hedge funds and other investors such as insurance

companies and pension funds scrambling over each other to invest in certain of the higher yielding financing products.

These drivers have resulted in a number of structural and specific changes, which the article outlines in more detail.

One of the key structural developments has been that, whilst European high yield issuances have been strong, leverage loans have seen much more significant growth. This has been driven partly by the benefits of leverage loans for private equity sponsor borrowers in contrast to high yield bonds, and partly by the preference of new investors in the market, such as CLO funds, for loan products.

Second lien loan volumes have also increased in frequency, becoming commonplace with second lien pieces developing from stretched senior seen in some recapitalisations to be standard tranches in most primary LBOs and almost all recaps.

Another recent development has seen the call protection inflexibility in fixed rate high yield bonds drive an increase in floating rate high yield bond issues. Many of the investors

Snippets continued ...

in these instruments are the same investors that have driven the increasing B (and to a lesser extent C) tranche domination of recent structures and recapitalisations.

The article discusses numerous recent changes in terms in traditional maintenance-based leveraged loan agreements which have been achieved by sponsors taking advantage of the current highly liquid investor base.

The article concludes by noting that many transactions are now done with only a commitment letter, term sheet, and interim facility agreement in place. One or two transactions have even been funded off the interim facility agreement.

PHOENIX COMPANIES

The April 2007 issue of the *Company and Securities Law Bulletin* contains an article by Peter Watts entitled **Phoenix companies - the common law and statutory regulation.**

The article considers some issues that arise in relation to phoenix companies in the light of the existing common law and the new phoenix company provisions of the Companies Act 1993.

A phoenix company is a company that has been "reborn" soon after (and in some cases before) its failure. The new company takes on the failed company's business, often using a similar name, the same managers and directors, and the same assets. The use of phoenix arrangements to sell the business as a going concern is an alternative to breaking-up and selling the business assets individually. In many instances, assets have been transferred from the failed company to the phoenix company at undervalue, although these cases are relatively straightforward as there are many remedies available to creditors in that circumstance.

The first part of the article discusses whether there are any legal grounds for complaint where the transfer of assets to the phoenix company has been at full value. That is, is there a duty on directors or owners to continue to run a company's business where it might remain viable to do so? Watts states that the basic position at common law is that the owners of a company have no duty to keep a business running, however viable. Following on from this, he concludes that the common law does not regulate the phoenix company phenomenon beyond ensuring that assets are transferred at full value.

Snippets continued ...

He then considers the new phoenix company provisions of the Companies Act 1993, which are expected to come into force in mid-October this year. These provisions will prohibit a director of a failed company from being involved in a company or business which has a name that is the same as, or similar to, any name used by the failed company within 12 months of its liquidation. The article then concludes by reviewing some United Kingdom case law on the issue of determining when a phoenix company is using a "similar name" to the old company.

TRANS-TASMAN FINANCIAL AND CAPITAL MARKETS

The June 2007 issue of the *Company and Securities Law Bulletin* contains an article by Frank Chan entitled **Emerging trends in the trans-Tasman financial and capital markets: harmonisation or assimilation?** This article seeks to explain recent developments in the harmonisation of trans-Tasman securities regulation within the context of current trends in global capital markets.

Chan discerns the current trends in capital markets that are leading towards the emergence of a true global market.

He then goes on to discuss the role that law and industry-based regulation can play to encourage capital raising within modern markets. Against this background, Chan provides a useful summary of the proposed legislation in Australia and New Zealand that will give mutual recognition to the securities laws of each country. He summarises the compliance issues under the proposed regimes for both (a) an Australian issuer wishing to extend an offer of securities to New Zealand, and (b) a New Zealand issuer wishing to extend an offer of securities to Australia.

As a concluding note Chan acknowledges the potential benefits for New Zealand issuers under the proposed regimes in that they have access to the much larger Australian market at a lower cost than before, but notes that the challenge for New Zealand is to ensure that there is a net inflow of funds into New Zealand, rather than a net outflow of funds to the many Australian offers that will become available in New Zealand.

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LEGAL ASPECTS OF VENTURE CAPITAL AGREEMENTS

The March 2007 issue of the *Company and Securities Law Journal* contains the article **The legal aspects of venture capital agreements: Part II** by Dylan Democrat Damon.

Part I appeared in the March 2007 issue of the same journal and was summarised in the April 2007 issue of Banking Law Update.

Part II of the article focuses on corporate governance issues in venture capital financing. These issues include:

- How are corporate rights to be assigned within the portfolio firm? A shareholder's agreement or an alteration to the firm's constitution are options.
- How do directors' duties apply to venture capitalists? A venture capitalist might not be formally appointed as a director yet still be subject to directors' duties as a shadow director.
- How is the dilution of shareholder rights upon a new issue of shares to be managed when a venture capital firm is in financial distress?

- How and when should a venture capitalist exit a venture capital investment?

GOING NATIVE

The July 2007 issue of the *International Financial Law Review* contains the article - **Market goes native: harnessing growing Kauri appetite** by Ross Pennington and Hoani Ashby.

This article covers the characteristics of Kauri Bonds, stating that they are issued either off Euro medium-term note (EMTN) programmes or Australia medium-term note programmes and that issuers have been drawn to the Kauri Bond market for, amongst other reasons, diversification of their investor base and the ability, through the basis swap, to achieve their US-dollar Libor-based funding targets.

The article goes on to explain documentation and transaction characteristics and outlines the required documents for an issue, which include terms and conditions, a distribution agreement and supplementary information, with a brief overview of the practicalities of such documents.

Snippets continued ...

The article has an explanation on the focal points in assessing a programme's suitability for Kauri issuance, identifying currency form of notes and alternative clearing systems as some of the features to be assessed for suitability with explanations as to the changes needed and why.

The article ends with explanations of the clearing and settlement procedures for Kauri Bonds, non-complying issues and how they may be remedied to be Kauri-suitable, and approaches to updating programmes to make them Kauri-suitable.

TAKING SECURITY OVER INTELLECTUAL PROPERTY: A PRAGMATIC APPROACH TO RELEASING VALUE FROM HIDDEN ASSETS.

The June 2007 issue of the *Journal of International Banking and Financial Law* contains an article by Jeremy Drew and Matthew Starmer entitled **Taking security over intellectual property: a pragmatic approach to releasing value from hidden assets.**

This article emphasises the importance of understanding the main types of intellectual property rights ("IPR") over which

security can be taken, as increasingly companies are using their IPR to maximise the amount of borrowing available to them.

IPR are rights granted to the creators of products and services and can be divided into two types. Registered IPR are statutory rights including patents, registered trademarks and registered designs. Unregistered IPR include copyrights, unregistered design rights and confidential information.

The article describes the steps that lenders should include in their due diligence process. These involve identifying the IPR, ensuring it is valid, and determining its importance to the business and realisable value.

The article concludes by advising that lenders should obtain undertakings and warranties from the borrower dealing with issues to protect the value of the security.

This publication is included in Russell McVeagh's website on the internet:

www.russellmcveagh.com

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