RUSSELL McVEAGH

# BANKING LAW UPDATE

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# CASES

## AMALGAMATION UNDER PART 15

*Elders New Zealand Limited v PGG Wrightson Limited (HC Wellington, CIV 2006-404-1974, 1 December 2006, Allan J)*

This case concerned an amalgamation of two companies, Pyne Gould Guinness Ltd and Wrightson Ltd ("**Wrightson**").

The defendant - PGG Wrightson Ltd, was amalgamated following Court orders approving the merger under Part 15 of the Companies Act 1993. Prior to this amalgamation Wrightson and the plaintiff - Elders New Zealand Limited ("**Elders**") were co-owners of a number of stock saleyards, in their own names or as co-owned companies. The rights and obligations of the co-ownership arrangements were regulated by agreements or the constitutions of the co-owned companies. These provided that pre-emptive rights be conferred on other co-owners in the event of an owner wishing to dispose of their interest.

The issue arose in this case because Elders argued that the Court ordered amalgamation under Part 15 of the Companies Act 1993 amounted to a transfer of the interest to the new company that triggered the plaintiff's pre-emptive rights. The Court held it did not amount to a transfer.

The issue was whether an amalgamation approved by the Court under Part 15 of the Companies Act gave rise to the same legal consequences as an amalgamation under Part 13 of the Companies Act. The Court held that it did.

Case law clearly provides that when companies are amalgamated under Part 13 of the Companies Act 1993 the companies "continue", and thus there is no transfer (*Carter Holt Harvey Ltd v McKernan* [1998] 3 NZLR 403). Elders argued that the scheme of Part 15 was different to that of Part 13. The following arguments were submitted by Elders and dismissed:

- Part 13 is an operation of law, while Part 15 is a consensual agreement and these differences created a distinction. The Court held that the different machinery in the Parts did not give rise to a conceptual distinction.

*Cases continued ...*

- The agreement was only binding on PGG and Wrightson, not on Elders, or other third parties and therefore did not affect the pre-emptive rights of Elders. The Court held that outcome would be untenable, and mean that parties outside the amalgamation would continue to deal with companies that no longer existed.

- The lack of "succeed" in Part 15 contrasted with Part 13 indicated that Part 15 was a transfer. The Court held that the use of the term "succeed" was deemed misleading, and irrelevant in this context.

- Part 15 allows the Court to make orders for transfer suggesting the amalgamation is not the same as Part 13 amalgamation. The Court held that Part 15 also includes arrangements and compromises, and the range of ancillary orders specified in section 237 reflects the wide jurisdiction of Part 15.

The Court held that there was no transfer in the Part 15 amalgamation, and that the scheme of the two Parts was the same for the purpose of amalgamations.

**EFFECT OF A SUBORDINATION AGREEMENT ENTERED INTO BY A GROUP OF COMPANIES WHEN A MEMBER OF THE GROUP BECOMES INSOLVENT**

*In re SSSL Realisations (2002) Ltd (in liquidation) v AIG Europe (UK) Ltd [2006] 2 WLR 1369*

This case considered the effect of a subordination agreement entered into by a group of companies when a member of the group becomes insolvent. The United Kingdom Court of Appeal held that such subordination agreements should be preserved during the process of a liquidation.

Save Group plc ("**Save**") and its subsidiaries (together, the "**Group**") were traders in petrol. Save was in charge of buying the petrol from the Group's suppliers and also of borrowing for the Group. Save would consequently borrow from banks and would then lend funds to its subsidiaries as necessary. This system resulted in considerable intra-group debts.

The Group had liabilities to the United Kingdom Customs & Excise that it arranged to satisfy by entering into an agreement with AIG Europe (UK) Limited ("**AIG**") pursuant

*Cases continued ...*

to which AIG provided bonds to Customs and Excise. Under the agreement, the Group agreed to indemnify AIG for the liabilities it assumed towards Customs & Excise in respect of the bonds. The agreement also subordinated the obligations of the Group companies towards each other to their obligations to AIG.

Shortly after entering into the agreement, Save and its subsidiaries, including SSSL Realisations (2002) Limited ("**SSSL**"), were wound up. The liquidators applied to the Court for direction as to whether AIG was protected by the subordination agreement from competing with claims from Group members in the process of SSSL's liquidation. The Court held that it was commercially important that the arrangement between the Group and AIG be upheld in a liquidation, not least because a liquidation was exactly the kind of situation that the subordination clauses in the agreement were intended to cover. Since the rights of the Group companies were subordinated to those of AIG, AIG was protected from competing with claims from companies within the Group.

Although it was not necessary to decide the issue, the Court of Appeal also held that the rule from *Cherry v Boultbee* (1839) 4 My & Cr 442, which requires that a person cannot claim in respect of the liquidation of a debtor to which that person owes a debt, does not apply where there is a set-off agreement between the two parties.

**PERSONAL PROPERTY SECURITIES**

*Simpson v New Zealand Associated Refrigerated food Distributors Limited* (Court of Appeal, CA36/06, 11 December 2006, William Young P, Glazebrook and Robertson JJ)

This case involved an unsuccessful appeal by Simpson against the decision in the High Court.

New Zealand Associated Refrigerated Food Distributors Limited ("**NZARFD**") sold Service Foods Manawatu Limited (in receivership and liquidation) ("**SFM**") goods subject to retention of title. SFM acknowledged by signing NZARFD's terms of trade that NZARFD "has a security interest in the goods supplied by NZARFD to SFM as detailed in each invoice supplied to SFM as well as the proceeds of such goods". NZARFD registered its security interest, pursuant

*Cases continued ...*

to the terms of trade on the Personal Property Securities Register ("**PPSR**").

Simpson, as receivers of SFM, submitted NZARFD's terms of trade did not create a security interest because the terms of trade did not specifically identify which, if any, obligations incurred by SFM were to be secured by the security interest which the terms of trade purported to create. SFM also claimed that the description of the collateral in the PPSR registration was not accurate enough to allow registration to be perfected.

The Court of Appeal upheld the High Court decision. It was satisfied that NZARFD had, pursuant to its terms of trade, a security interest in the goods supplied to SFM and not paid for, and any traceable proceeds of sale of those goods, and that NZARFD perfected its security interest by registration.

The Court found that validity of the PPSR registration was not affected by the overly broad description of the collateral in the PPSR registration. Notwithstanding its finding, the Court noted that best practice suggests that the description of the collateral in a PPSR registration should reflect accurately the collateral in which a secured party has a security interest.

# LEGISLATION

**REGULATIONS UNDER THE SECURITIES AMENDMENT ACT 2006 AND THE SECURITIES MARKETS AMENDMENT ACT 2006**

The Minister of Commerce has sought the approval of the Cabinet Economic Development Committee to develop regulations under the Securities Act 1978 and the Securities Markets Act 1988 following the 2006 amendments to both Acts. A paper released by the Minister on 20 December 2006 sets out the proposed content of the regulations.

*Substantial Security Holders' Disclosure*

The current Securities (Substantial Security Holders) Regulations 1997 set out the form and content of what must be disclosed by substantial security holders. The 2006 amendments to the Securities Markets Act require that the 1997 regulations be updated.

It is proposed that the 1997 regulations remain basically unchanged save for the necessary updates to ensure that they are consistent with the 2006 amendments.

The Minister has recommended several other minor changes, including:

- exemptions for overseas-listed companies that are subject to equivalent requirements in their home jurisdiction;
- redesign of the disclosure form following future consultation with New Zealand Exchange Limited; and
- compulsory electronic filing in most circumstances.

*Market manipulation*

It is proposed that regulations be passed that exempt market stabilisation following an offer of securities that complies with specified conditions (including, among others, size, disclosure, advance notification and record-keeping) from the prohibition on market manipulation. The regulations will also clarify that a sale of securities will not be manipulative solely because the seller does not hold the securities at the time of sale (ie short selling) and that off-market transactions in listed securities will not be manipulative solely because the trades do not take place on the market (ie trade crossings).

*Investment advisers' and brokers' disclosure*

The Securities Markets Act sets out disclosure obligations for investment advisers and brokers. The Minister proposes to make regulations that:

- provide the required definition of "bank term deposit";
- exempt some classes of investment advice (eg telephone advice) and investment adviser (eg lawyers and chartered accountants) from the full disclosure requirements of the Act;
- provide that disclosure must be clear, concise, and in plain language and that it adhere to set headings; and
- clarify that where an advisor is giving general advice on securities, disclosure can be general, but where the adviser, if advising on specific securities disclosure, is expected to be equally more specific.

*Insider trading*

Regulations are not required to exempt passive investment vehicles from the insider trading regime at this stage because they are not currently caught by the regime and consequently none are proposed.

*New website*

The Securities Commission has set up a website to keep people informed about the progress of these and other changes to securities law. The new website is accessible at www.newsecuritieslaw.govt.nz

**Changes to NZX rules**

The New Zealand Exchange Limited ("**NZX**") submitted proposed amendments to the NZX Participant Rules to the Minister of Commerce on 21 December 2006. The Minister of Commerce may disallow the rules within 40 working days. Assuming that no rules are disallowed, NZX expects the rules to become effective on or around 1 May 2007.

*Legislation continued ...*

NZX also submitted proposed amendments to the NZAX Listing Rules to the Minister of Commerce in January 2007. There is similarly a 40 working day period in which the Minister of Commerce can disallow any rules. Assuming that no rules are disallowed, NZX expects the changes to become effective as soon as the disallowance period ends, that is, around mid March 2007.

The proposed amendments to both the NZX Participant Rules and the NZAX Listing Rules can be viewed at www.nxz.com/regulation

## SNIPPETS

**RISK TO THE VALIDITY OF MORTGAGE**

**MINISTRY OF ECONOMIC DEVELOPMENT'S REVIEW OF FINANCIAL PRODUCTS AND PROVIDERS**

The November 2006 issue of *Butterworths Journal of International Banking and Financial Law*, contains an article entitled **Swimming against the tide?** by Elizabeth Ovey:

- This article highlights recent case law to show that the greatest risk to the validity of a mortgage is still that a mortgagor's signature has been obtained by misrepresentation or undue influence. This is despite the efforts of the House of Lords in the Royal Bank of Scotland v Etridge (no2) [2002] AC 773 to give lenders guidance on how to ensure the validity of their security. The author notes this is no doubt due in part to the fact that the relevant documentation may have been signed years before the issue becomes a live one - and years before a lender has put Etridge systems in place to minimise the risk. Accordingly the author concludes that there is little that can be done now to avoid or reduce these historic problems but they are worth bearing in mind when a mortgagee is deciding whether to pursue litigation where undue influence is alleged.

The article also looks at matters arising during the currency of the mortgage by considering the case of Paragon plc v Pender [2005] 1 WLR 3412. The case is further authority that there are limits to the apparently absolute discretion to vary interest rates. However, the Court of Appeal recognised the importance of a lender's own commercial interests and held that to raise interest rates for a genuine commercial reason will not breach an implied term not to set interest rates improperly, capriciously, arbitrarily or in a way which no reasonable mortgagee, acting reasonably, would do. The Court also declared that fair dealing requires the power to vary interest rates to be disclosed. This decision highlights the divergence between the approaches by the Court and the UK Financial Services Authority, the latter of the two having adopted the wider approach of Treating Customers Fairly.

*Snippets continued ...*

**SUMMARY OF THE HISTORY OF THE DEFINITION OF "DEPOSIT-TAKING" AND THE CONCEPT OF A "DEPOSIT"**

The December 2006 issue of the *Journal of Banking and Finance Law and Practice* contains an article by Rhys Bollen entitled **Time to modernise the concept of "deposit"?**

- This article contains an interesting summary of the history of the definition of "deposit-taking" and the concept of a "deposit". It traces the origins of the modern banking system back to the deposit of gold with goldsmiths and the use of the goldsmiths' receipts as a payment system in the 17th century. Bollen goes on to examine the legal definitions of deposit-taking and banking business and considers that in light of recent developments in the banking world (such as the use of credit cards and purchase payment facilities such as smart cards and electronic cash), the definition of deposit-taking needs to be reviewed. It argues against defining deposit-taking by reference to entities that the community wants regulated as banks and for a functional definition that recognises deposits for what they are.

  It proposes the following definition: "the contractual loan arrangement between a financial institution and client where the client places funds with the institution for later withdrawal or use in making payments". The article concludes with a discussion of the regulation of deposit-taking and the practical implications of a modernisation of the concept of deposit for those regimes.

**THE IMPLICATIONS OF THE INTERNATIONAL ACCOUNTING STANDARDS AND BASEL II ON COLLATERALISED DEBT OBLIGATIONS**

**CONFLICTS OF INTERESTS IN FINANCIAL SERVICES AND MARKETS**

The December 2006 issue of the *Journal of International Banking Law and Regulation* contains the following articles of interest

- **CDOs under siege - Part II: IAS derecognition and BASEL II**, part II of a two part article by Kirill Glukhovskoy and Joseph Tanega. This article examines the implications of the International

*Snippets continued...*

Accounting Standards ("**IAS**") and Basel II on Collateralised Debt Obligations ("**CDOs**"), initially looking at the question of derecognition in the IAS and then turning to the features of the Basel II rules concerning the operational requirements for traditional securitisations which apply to CDO structures. The article considers that CDO structures that achieve successful compliance in terms of accounting standards and capital adequacy regulations are likely to attract increased cost. Reasons given are that the IAS and Basel II are more sophisticated than their predecessors, and thus require enhanced sophisticated scrutiny. Further, problems of cross-compliance are perceived that will require 'innovative solutions', which will justify third party advisors pushing up the cost of their compliance services.

- **Conflicts of interests in financial services and markets**, part I of a two part article by Christa Band. This article discusses conflicts of interests, specifically in the area of financial services and markets, from a legal perspective.

The author considers the general definition of fiduciary relationships, before moving on to consider the existence of fiduciary duties in the commercial context. It concludes such duties do exist, primarily when one party is exercising discretion on behalf of the other. The duty is limited to supporting this discretion.

This article then looks at the four fiduciary duties within these relationships, as identified by the Law Commission, in the context of a financial services institution. Specifically these are the no conflict rule, the no profit rule, the undivided loyalty rule and the duty of confidentiality. It also considers how to limit an advisor's conflicts of interest, either by structuring the relationship so there is no discretion giving rise to a need for fiduciary duties, through contractual limitations, or disclosure of, and consent to, such conflict.

*Snippets continued ...*

**AN UPDATE ON PPSA CASES IN NZ**

*The Australian Banking and Finance Law Bulletin, Issue 5 & 6, 2006* contains an article by Steve Flynn and Mariette van Ryn entitled **An update on PPSA cases in NZ** which traverses recent case law on the Personal Properties Securities Act 1999 ("**PPSA**")

- The article questions the result in the Court of Appeal case of *Portacom*, and also covers *NZ Bloodstock*. It considers when a lease stops being a security interest and the application of section 23(e)(ix) of the PPSA to exclude from the PPSA priority rules the assignment by the debtor to the lessor of prospective fees. The article also contemplates the issues surrounding preferential creditor claims if any were to exist in this situation.

  The article considers recent High Court cases, including a discussion of the level of behaviour required to satisfy section 25 of the PPSA, the relationship between section 5 of the PPSA and Part 5 of the Credit Contracts and Consumer Finance Act 2005 (*Pacific Travel*), the purpose and effect of section 30A of the Receiverships Act 1993 and its relationship to section 117 of the PPSA (*Building Depot*) and whether liquidators are a 'third party' for the purposes of sections 40(1)(c) and 36(1)(b) of the PPSA (*King Robb*, currently under appeal).

  It also criticises the decision in *McTavish* where a security not perfected under the PPSA was lost in a priority contest with a creditor. The article concludes that the decision was made on an erroneous basis, but that the correct result was reached when one considers section 103 about 'execution creditors'.

**EFFECTIVENESS OF AUSTRALIA'S DUAL REGULATOR APPROACH TO THE FINANCIAL SERVICES INDUSTRY AGAINST THE PERCEIVED BENEFITS OF A SINGLE FINANCIAL SERVICES REGULATOR**

The December 2006 issue of the *Australian Journal of Corporate Law* contains an article by Michael A Adams, Angus Young and Marina Nehme entitled **Preliminary review of over-regulation in Australian financial services**

*Snippets continued ...*

- The article examines the effectiveness of Australia's dual regulator approach to the financial services industry against the perceived benefits of a single financial services regulator.

  It first considers the significance of the financial services industry to Australia's economy, noting that financial and insurance industries comprise 8.5%, or A$62 billion, of Australia's GDP. The article goes on to discuss the background to Australia's financial services regulation, detailing a number of government commissioned reports which resulted in the implementation of a dual track regime nearly a decade ago. The authors give an overview of that dual track regime, which comprises the Australian Prudential Regulatory Authority ("**APRA**") and the Australian Securities and Investments Commission ("**ASIC**").

  APRA is the prudential regulator of the financial services industry, overseeing banks, credit unions, building societies, general insurance and reinsurance companies, life insurance, friendly societies and most members of the superannuation industry.

  Broadly, APRA's mission is to establish and enforce prudential standards and practices to ensure that, under all reasonable circumstances, financial promises made by institutions it supervises are met within a stable, efficient and competitive financial system. On the other hand, ASIC regulates companies and securities and futures industries, with the aim of promoting confidence in Australia's financial markets, corporations and businesses.

  The article states that the dual track regime, together with a consistent licensing regime, has greatly increased the costs of compliance for members of the financial services industry. The authors consider there are clear economic arguments, as well as international experiences, which state that a single financial services regulator is more effective than the multi-layered approach adopted in Australia. In particular, in the superannuation area of financial services (worth $A800 billion) there is unnecessary dual licensing and duplicated regulation, with little evidence of any consumer-member benefit, but at a much greater cost.

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

www.russellmcveagh.com

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