

RUSSELL McVEAGH

BANKING LAW UPDATE

DATE | MARCH 2007

PRINT

CASES

BREACH OF DIRECTORS' DUTIES - RECKLESS TRADING

Goatlands Ltd (In Liquidation) v Borrell (HC Hamilton, CIV.2005-419-1643, 14 December 2006, Lang J)

In May 2001 Goatlands Limited ("**Goatlands**") entered into an agreement to purchase a farm property, with the purchase to be settled a year later in May 2002. Prior to settlement, Goatlands received a GST refund in respect of the purchase of the property. The directors of Goatlands (the Borrells) subsequently used the GST refund to pay the required deposit on the property and to make rental payments on the property for the period up until the purchase was to be settled. They did so knowing that the company's purchase of the property would go through only if they personally could sell a significant portion of their existing landholding. Ultimately, the purchase of the property failed and Goatlands became liable to repay the GST refund. It was unable to do so and Goatlands was placed in liquidation.

The liquidators of Goatlands argue that the Borrells, in their capacity as directors, breached their duty under s135 of the Companies Act by causing or allowing the business to be

carried on in a manner that was likely to create a substantial risk of serious loss to its creditors. They also argued that the Borrells agreed, in breach of their duty under s136, to Goatlands incurring a contingent obligation to repay the GST refund in circumstances where they did not believe on reasonable grounds that they would be able to do so.

In his judgment Justice Lang discussed the test for reckless trading under s135. He noted that a distinction had to be drawn between 'legitimate business risks' and 'illegitimate business risks' and that an objective approach should be taken in deciding whether the particular conduct is inappropriate under s135. On the facts Justice Lang found that the risk of the transaction failing amounted to a substantial and illegitimate risk.

In relation to s136 he found that the Borrells did not believe on reasonable grounds that the company would be able to perform the obligation when required to do so.

The Borrells were ordered to contribute, by way of compensation, approximately 25 percent of the company's indebtedness. In arriving at this figure Justice Lang considered the couple's culpability for the company failing.

Cases continued ...

CROSS BORDER INSOLVENCY

Re HIH Casualty and General Insurance Ltd; McMahon v McGrath [2007] 1 All ER 177

This UK Court of Appeal case involved an interesting issue that often arises in a cross border insolvency, namely the circumstances in which a court in one country with jurisdiction in relation to insolvency proceedings should "assist" the courts of another country having a corresponding jurisdiction. This case is particularly relevant to New Zealand given the passage of the Insolvency (Cross-border) Act 2006 in November 2006. The purpose of this Act is to implement the United Nations Commission on International Trade Law Model Law on Cross Border Insolvency, which provides for domestic recognition of foreign insolvency proceedings and co-operation between courts in a cross-border insolvency situation.

The Court of Appeal had to consider whether to exercise its discretion under s426(4)(5) of the Insolvency Act 1986 to accede to a request for the transfer of assets held by English liquidators in the liquidation of certain companies incorporated in Australia. The companies were part of a

group that had been the second largest insurer in Australia until its collapse in 2001. An Australian court had ordered that the companies be wound up and joint liquidators were appointed. Because the companies had substantial assets in the United Kingdom, provisional liquidators were also appointed in England (but no winding-up orders were made in England).

The insolvency regimes in both countries were broadly similar. However, the Australian preferential creditor provisions provided for creditors of an insurance company with insurance claims to have priority over other creditors. The Australian liquidators sent a letter to the English High Court requesting the High Court to direct the English provisional liquidators to pay over to the Australian liquidators all sums collected by them so that they could be applied in accordance with Australian insolvency law. The issue in this case was whether the Court had jurisdiction to entertain such a request, and if so, whether the directions should be given.

Both the High Court and the Court of Appeal held that the Court did have jurisdiction to entertain the request. However, both Courts held that they could not accede to

Cases continued ...

the request because the remission of English assets to Australia would prejudice, and would diminish, the assets available for distribution to non-insurance creditors. While the Court of Appeal recognised that an English court did not have to find the distribution regimes to be identical in scope before consenting to such an order, the prejudice in this case clearly pointed against giving the order.

LEGISLATION

MOU WITH DUBAI FINANCIAL SERVICES AUTHORITY

On 26 February 2007 the New Zealand Securities Commission signed a memorandum of understanding ("**MOU**") with the Dubai Financial Services Authority. The MOU sets out arrangements for the two regulators to cooperate and share information in relation to enforcement of securities law.

The arrangement is similar to a number of other bilateral MOUs that the Commission has with other overseas regulators. These arrangements, along with the Multilateral MOU of the International Organisation of Securities Commissions, aim to strengthen cooperative networks to help counter cross border securities fraud.

SECURITIES COMMISSION OVERSIGHT REVIEW OF NEW ZEALAND EXCHANGE LIMITED

On 1 February 2007 the Securities Commission announced the terms of reference for its review of NZX's performance in 2006. The review will focus on the NZAX market; processes regarding admission or approval of listed issuers and market participants; and NZX's role in minimising the risk of non-compliance by its listed issuers and market

participants. Also considered will be developments in the areas identified in last year's first annual oversight review, as well as NZX's progress towards implementing that review's recommendations. The Commission expects to complete its review and publish a report by 30 June 2007.

LIFE INSURANCE TAX REFORM

In September 2006 the Inland Revenue Department ("**IRD**") released an officials' paper outlining the scope of a proposed review of the rules for the taxation of life insurance policies and providers. This officials' paper suggested two possible options for the structure of life insurance taxation: the first option was based on updating the current taxing methodology, while the second option involved integrating the life insurance tax rules with the financial accounting rules for life insurance, which would tax life insurers on the same principles as general insurers ("**Option 2**"). The October 2006 issue of BLU included a discussion on this officials' paper.

On 27 February 2007 the IRD released a second officials' paper on life insurance tax reform that addresses Option 2 in more detail. The IRD currently prefers this option.

Legislation continued ...

The paper sets out the IRD's proposed model for life insurance taxation. The proposed model would require two calculations for the two kinds of income that would be covered by the rules: one in relation to shareholders' income and a second in relation to policyholders' income. It is proposed that shareholders' income be taxed in much the same way as the income of shareholders of companies in general, ie at the company tax rate and with the benefit of the imputation credit regime.

Policyholders' income would be treated as a form of savings investment. The IRD therefore considers it appropriate to allow some aspects of policyholders' income the benefit of the new Portfolio Investment Entity ("**PIE**") rules, which come into force on 1 October 2007 (discussed in BLU December 2006). It is proposed that some forms of policyholders' income could be taxed in essentially the same manner as investment income from PIEs, that is, the life insurer could elect for particular classes of income to be attributed to individual policyholders and taxed at the individuals' marginal tax rates. All tax on policyholders' income would be paid by the life insurer on behalf of the taxpayer.

The officials' paper is available from www.taxpolicy.govt.nz
Submissions close on 5 April 2007.

SNIPPETS

MONEY LAUNDERING

Issue two 2007 of the *Journal of International Banking Law and Regulation* contains an article by Ian Huskisson entitled "**General suspicions of money laundering not sufficient to make bank liable for knowing or dishonest assistance**".

The article discusses the case of *Adnan Shaaban Abou-Rahmah v City Express Bank of Lagos* (2006 EWCA Civ 1492) where money was routed through a bank as part of a fraud perpetrated by the banks' customers. The victims of the fraud sued the bank on the basis that the bank had requisite knowledge of the fraud.

The Court of Appeal held that the bank manager's suspicions of involvement in money laundering "in a general way" were not sufficient to show that the bank had acted in a way that was contrary to normally acceptable standards of honest conduct. The Court held that there needed to be particular suspicions about the transaction in question, and that suspicions as to general integrity of the customer were not sufficient.

The article concludes that there is a fine line to be drawn between "general" and "transactional" suspicions, and each case will turn on its own facts. The author considers that Banks may however draw comfort from the decision faced with future dishonesty claims.

MORE ON MONEY LAUNDERING

The January 2007 issue of the *Australian Banking and Finance Law Bulletin* contains the article ***The Anti-Money Laundering and Counter-Terrorism Financing Act is launched*** by Andrea Beatty, James Moore and Nicholas Smith.

The Act that is the subject of the article extends the coverage of the identification and reporting obligations of the *Financial Transaction Reports Act 1988* (Cth). The AML/CTF applies to businesses that provide one of the 54 financial, two billion dealing or 14 gambling services it designates as "reporting entities".

Snippets continued ...

The Act's obligations commence in stages over 24 months beginning on 13 December 2006 and can be grouped into four main areas:

- Customer due diligence: businesses must identify their customers, verify that identification is correct and monitor customer transactions.
- Reporting: businesses must report transactions that exceed a certain threshold, international funds transactions and all other suspicious matters to the Australian Transaction Reports and Analysis Centre (AUSTRAC).
- AML/CTF program: businesses must create and maintain an AML/CTF program.
- Record keeping: businesses must maintain records of their actions under the Act.

The Minister for Justice and Customs has indicated there will be a prosecution-free period of 15 months beginning from the introduction of each obligation; however, a reporting entity will escape prosecution only if it can demonstrate to

AUSTRAC that it has made "best endeavours" to comply with the legislation. Such lenience is necessary because compliance is onerous, there are a wide range of affected businesses and the penalties for non-compliance are severe (the maximum civil penalty is A\$11 million). In addition, a defence is available to a defendant who proves that it took reasonable precautions and exercised due diligence to avoid contravention of the Act.

LEGAL ADVICE PRIVILEGE AND CONTENTIOUS COURT DOCUMENTS

The 2007 January issue of the *Australian Banking and Finance Law Bulletin* contains the article **Legal advice privilege and contentious court documents: a UK case** by Robert Hickmott and Emily Springford. This article examines the scope of legal advice privilege and the circumstances in which a court will view contentious documents.

In the recent decision in *National Westminster Bank plc v Rabobank Nederland*, the UK High Court confirmed that the scope of legal advice privilege is as set out in *Three Rivers District Council v the Governor and Company of the Bank of England*: legal advice privilege attaches only

Snippets continued ...

to documents passing between the client and legal advisers, not preparatory materials, even if the materials were created to enable lawyers to advise. As the documents in this case were preparatory work, created during an internal investigation, legal advice privilege did not apply.

The judge refused to examine the documents to determine whether they were protected by litigation privilege. His Honour considered that generally the court should not inspect documents unless there is evidence that the lawyers have either misunderstood their duty or are not to be trusted and there is no practical alternative.

The article concludes that litigants are limited in the extent to which they can rely on legal advice privilege in relation to preparatory work for clients and, where possible, the courts will rely on the evidence of parties and their solicitors and try to avoid reviewing documents.

CAPITAL IDEAS

The February 2007 issue of *NZ Business* contains an article entitled **Capital ideas** by Glenn Baker. The article explores the various options for raising business finance for SMEs.

Most businesses have to borrow money in order to grow. However, businesses should first consider what type of growth the business requires – start-up, increased capacity through plant acquisition, or to fund current trading. One of the areas that the article explores is the concept of working capital finance whereby future profits are realised in order to invest within the current business operations.

The article looks at two key avenues for financing: non-banks and banks. Non-banks (personal equity, family, friends) can be complemented by finance companies that can assist through capital finance, trade finance, debtor finance, and factoring. Alternatively, "angel investors" and venture capitalists can assist with both funding and expertise.

The article notes that banks are currently said to be "more flexible and responsive" through tailoring financing to individual businesses' needs. However, predictions note that the current economic cycle may see banks reducing business funding in the next two to five years.

Snippets continued ...

BANKS, UNCONSCIONABILITY AND ECONOMIC DURESS – A SMALL STEP TOWARDS DEREGULATION?

The 2006 Volume 17 issue of the *Journal of Banking and Finance Law and Practice* contains an article by Peter Gillies entitled **Banks, unconscionability and economic duress - a small step towards deregulation?**

This article examines the case of Australia and New Zealand Banking Group (ANZ) v Karam ((2005) 64 NSWLR 149; [2006] ATPR 42-089) and canvasses the scope of the unconscionable conduct and economic duress doctrines. The article notes the importance of the *ANZ v Karam* decision in confirming that:

- The equitable doctrine of unconscionable conduct is qualified by a requirement of special disability;
- The common law recognises a doctrine of economic duress, but it is confined to conduct that is unlawful per se;
- Given that economic duress is confined to conduct that is unlawful per se, the doctrine of

unconscionable dealing cannot be used to create an open-ended doctrine of unconscionability; and

- The fact that a plaintiff is under economic pressure, even where the defendant knows of this circumstance, does not in itself provide a foundation for a finding that the defendant's conduct was unconscionable, nor does it ground a remedy in economic duress.

The article also discusses how the decision in *ANZ v Karam* is directly relevant to the interpretation of the unconscionable conduct provisions in the *Trade Practices Act 1974 (Cth)* and the *Australian Securities and Investments Commission Act 2001 (Cth)*, which import the general law doctrine of unconscionability.

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

www.russellmcveagh.com

This transmission/publication is intended only to provide a summary of the subject covered. It does not purport to be comprehensive or to provide legal advice. No person should act in reliance on any statement contained in this publication without first obtaining specific professional advice. If you require any advice or further information on the subject matter of this newsletter, please contact the partner/solicitor in the firm who normally advises you, or alternatively contact:

Prue Flacks or Guy Lethbridge | WELLINGTON

John Powell or Ross Pennington | AUCKLAND

ISO 9001 Certified - Quality Assured Supplier

WELLINGTON

VODAFONE ON THE QUAY 157 LAMBTON QUAY
PO BOX 10-214 WELLINGTON NEW ZEALAND
PHONE 64 4 499 9555 FAX 64 4 499 9556

AUCKLAND

VERO CENTRE 48 SHORTLAND STREET
PO BOX 8 AUCKLAND NEW ZEALAND
PHONE 64 9 367 8000 FAX 64 9 367 8613

PRINT