

RUSSELL McVEAGH

BANKING LAW UPDATE

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CASES

ENFORCING A GENERAL SECURITY AGREEMENT

Harvestpro Logging Limited v Cordyline Holdings Limited (HC Auckland, CIV 2006-404-3107, 3 October 2006, Associate Judge J P Doogue)

Cordyline Holdings Limited ("**Cordyline**") entered into an agreement with ForestOne under which Cordyline provided four logging trucks and trailers to ForestOne. The key issue to be decided in this case was whether this agreement was properly characterised as a leasing agreement or as a sale and purchase agreement.

ForestOne took possession of the trucks and made two of the series of periodic payments provided for under the agreement. After making two payments, however, ForestOne defaulted and then ceased trading.

One of ForestOne's other creditors was Harvestpro Logging Limited ("**Harvestpro**"). Harvestpro had a general security agreement over the present and after-acquired property of ForestOne. After ForestOne ceased trading, Harvestpro attempted to enforce its general security agreement by taking possession of ForestOne's property, including the four

logging trucks. However, Cordyline had already directed a repossession agent to reclaim the trucks. Harvestpro consequently sued Cordyline for the tort of conversion.

Cordyline argued that the trucks were not part of ForestOne's property because they had not been sold to ForestOne, only leased, and consequently were not covered by the general security agreement. Associate Judge J P Doogue found, however, that the agreement was for sale and purchase on the basis that the agreement was labelled a "sale and purchase agreement" and Cordyline described within it as the "vendor" and ForestOne as the "purchaser". The property had accordingly passed to ForestOne. The Judge held that the elements of conversion were satisfied and found in favour of Harvestpro.

MORTGAGE LENDERS - MORTGAGEE POWER OF SALE

Meretz Investments NV and another v ACP Ltd and others
[2006] 3 All ER 1029

This case principally concerns the effectiveness and legal consequences of a purported sale by a mortgagee of a lease

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of a partially completed penthouse development on the roof of a block of flats.

The facts of the case are complicated. In essence, B (freehold owner of the flats) granted a lease of the roof to ACP to enable penthouse development. ACP granted a charge over the lease to its parent company, F. The charge contained an express power of sale. F subsequently enforced the charge purporting to sell the lease to unrelated T (who would complete the development).

B argued the power of sale had been exercised for improper purposes and was exercised in bad faith to take control of the development and avoid the obligation ACP had to share with B the receipts of sale of the development.

B submitted that a power of sale could only be properly exercised where the mortgagee had a "purity of purpose": that is to say, where the mortgagee's only motive is to recover, in whole or in part, the debt secured by the mortgage. It was submitted also that if the mortgagee had mixed purposes, the requisite purity of purpose was not achieved and the exercise was improper.

The Court held that there is support for the proposition that a power of sale may be improperly exercised if it was not part of the mortgagee's purpose to recover the debt secured by the mortgage. The Court held, however, that where a mortgagee had mixed motives or purposes, one of which was a genuine purpose of recovering, in whole or in part, the amount secured by the mortgage, then the exercise of the power of sale would not be invalidated, commenting that a dissection of mortgagee's motives is likely to be difficult in practice. The Court confirmed that it is legitimate for a mortgagee to exercise its powers for the purpose of protecting its security.

The Court found that, given at least one of F's purposes in exercising the power of sale had been to recover what money it could out of the project, its power had been exercised for a proper purpose and was not in breach of any equitable duty owed to B. This was the case despite the parent/subsidiary relationship between ACP and F.

Unless a lack of good faith can clearly be demonstrated as the mortgagee's fundamental purpose, this case suggests a borrower's challenge of a repossession or sale is unlikely to be successful.

Cases continued ...

COLLATERAL DEBENTURE A DEBT SECURITY OFFERED TO PUBLIC

The 11 October 2006 update of "CCH New Zealand Company Law and Practice" contains a summary of the recent High Court decision in Assistant Registrar of Companies v Lombard Financial Services (2006) 9 NZCLC 264, 146.

Under the Securities Act 1978 ("**Act**") interests in contributory mortgages offered to the public by a contributory mortgage broker are excluded from the definition of debt securities and thus not regulated by the Act. However, where the loan secured by the contributory mortgages is also secured by a debenture, that debenture will constitute a debt security, meaning the offer must comply with requirements under the Act.

The case of *Lombard* involved a contributory mortgage broker offering interests in a contributory mortgage to the public. There was additional security in the form of a debenture. The investment memorandum for the offer stated the Loan to Value of Business ratio as 66.6%. The Loan to Land Valuation ratio of 80% was not stated in the offer documents.

The Assistant Register of Companies alleged that:

- the Securities Act requirements for an offer of debt securities to the public were not met; and
- the information provided to the public in the offer documents was untrue and/or misleading.

The High Court held that the debenture was a debt security and was offered to the public. It rejected an argument that the debenture was only a collateral security and therefore not offered to the public. The court stated that the security must be considered in the context of the whole transaction. In this regard they noted that the broker chose to highlight the loan to value of business ratio - 66.6% - and could not do so without including the assets secured by the debenture. Therefore the debenture was offered to the public and the investment memorandum had failed to comply with the Act's requirements for offers of debt securities.

The High Court also held that the statement of the loan to valuation ratio in the offer document was untrue and/or misleading by omitting the loan to land value ratio and

Cases continued ...

rejected an argument that individual investors could work out the true position.

APPOINTMENT OF ADMINISTRATIVE RECEIVERS IN ENGLAND

Feetum v Levy [2006] 3 WLR 427 (CA)

Section 72A of the Insolvency Act 1986 (UK) ("**Act**") provides that "the holder of a qualifying floating charge in respect of a company's property may not appoint an administrative receiver of the company". However, Section 72E(1) of the Act provides "Section 72A does not prevent the appointment of an administrative receiver of a project company of a project which (a) is a financed project, and (b) includes step-in rights".

Cabvision Ltd ("**CV**") generated revenue from advertising in taxis. It developed a computer software system ("**ICT Software**") for the display of information in the passenger compartment of taxis. CV entered into an ICT Software agreement with Tower Taxi Technology LLP ("**LLP**"), a vehicle formed to raise funds for CV, for the purchase by

LLP of the necessary licences to exploit the ICT Software. LLP then entered into a facility agreement with Lloyds, for a loan in the amount of £67.5m or three times the aggregate of LLP's members' capital contributions, whichever was lower. Subscriptions only totalled £6,780,894 so LLP drew down £20,342,682. Bank of Scotland guaranteed the Lloyds loan, in consideration for an indemnity from CV. LLP in turn agreed to indemnify CV in respect of CV's liability to Bank of Scotland, LLP's indemnity to CV being secured by a debenture.

The debenture contained a power for CV to appoint an administrative receiver over LLP's property and undertaking on the occurrence of an "insolvency event". Subsequently, CV purported to appoint administrative receivers of the property and undertaking of LLP, contending that an insolvency event had occurred.

On summary judgment in the High Court LLP successfully sought a declaration that the purported appointment of administrative receivers of the LLP by CV was invalid, being contrary to section 72A of the Act. CV appealed on the grounds that:

Cases continued ...

- (a) the founders of the LLP did not have the status to seek the declarations as any wrong had only been done to LLP. The Court of Appeal rejected this as the claimants, as designated members, were not only directly interested in the issue as to the validity of the appointment but also directly affected by it;
- (b) the "financed project" test in section 72E(1) was met because a loan in excess of the amount of the threshold was, or would be, available and the parties intended that an amount in excess of the threshold would be drawn down if the project succeeded under both the ICT Software agreement and the facility agreement. The Court of Appeal held that the relevant agreement was the Lloyds' facility agreement and not the agreement between LLP and CV. However, it was not possible to resolve the issue on an application for summary judgment; and
- (c) the power to appoint a receiver amounted to "step-in rights". The Court of Appeal rejected this argument because, in their opinion, the meaning of "step-in

rights" in the Act did not equate with a power for a financier to appoint an administrative receiver.

Accordingly, the appointment of receivers under the right contained in the debenture did not fall within the section 72E exception and the general prohibition applied. The appeal was dismissed.

LEGISLATION

BUSINESS LAW REFORM ACT

The Business Law Reform Act ("**Act**") was passed on 16 November 2006, having been reported back from the Commerce Committee on the 18 October 2006. The Act amends five other statutes:

- the Companies Act 1993;
- the Dumping and Countervailing Duties Act 1988;
- the Financial Reporting Act 1993;
- the Friendly Societies and Credit Unions Act 1982; and
- the Insurance Companies Deposits Act 1953,

with consequential amendments to other legislation.

Changes the Act makes include:

- most small companies will be eligible for the exempt companies regime, which has simpler financial

statement requirements;

- company directors will be liable for infringement notices and fines if they fail to file their company's annual return by the due date;
- overseas registered companies will not be subject to more filing requirements than New Zealand registered companies; and
- a prohibition on companies that are not in the insurance business from using the words "insurance" in their names.

NEW ZEALAND AND AUSTRALIA MUTUAL RECOGNITION OF SECURITIES OFFERINGS

On 10 September 2006 the Minister of Commerce released draft regulations to implement the next step in coordinating business law in New Zealand and Australia. The draft regulations will enable a mutual recognition of securities offerings. The draft regulations are available at www.med.govt.nz

Legislation continued ...

The draft regulations are the latest step in the implementation of an agreement between the governments of New Zealand and Australia to recognise each other's securities offer documents. For its part, the Australian government has published an exposure draft of its Bill that will enable the recognition of New Zealand securities offerings. The exposure draft is available at www.treasury.govt.au

TAX PENALTIES REGIME

On 17 October 2006 the Minister of Finance and the Minister of Revenue jointly released a discussion document on tax penalties. The changes proposed in the discussion document are intended to encourage voluntary compliance and better align the penalties imposed with the seriousness of the offence and culpability of the offender. The proposals include:

- prescribing circumstances in which a shortfall penalty can be imposed for not taking reasonable care even when taxpayers have used a tax agent;
- removing GST and withholding-type taxes from the scope of the unacceptable tax position penalty;

- changing the threshold for assessment of the unacceptable tax position shortfall penalty so that the penalty can be imposed only when the tax shortfall arising from the taxpayer's tax position is more than both \$50,000 and 1% of the taxpayers total tax figure for the relevant period;
- notifying a taxpayer the first time a payment is late, rather than imposing an immediate late payment penalty;
- extending the late filing penalty to GST returns; and
- penalties for not taking reasonable care or for taking an unacceptable tax position would not be imposed if the taxpayer made a voluntary disclosure within two years and before an audit had commenced.

Submissions on the proposed changes close on 30 November 2006. A copy of the report is available from <http://www.taxpolicy.ird.govt.nz>

Legislation continued ...

COMPLIANCE WITH FATF RECOMMENDATIONS

The Ministry of Justice recently released a report entitled Anti-Money Laundering and Countering the Financing of Terrorism: New Zealand's compliance with FATF recommendations. The discussion document is the third in a series of three papers on the legislative reforms necessary in order to ensure New Zealand's compliance with international standards for countering money laundering and terrorist financing set by the financial action task force ("**FATF**").

The discussion document considers the FATF requirements for regulation and supervision, assesses the adequacy of the current arrangements, and recommends improvement. The paper recommends a two-stage implementation process for the supervisory reforms. The first stage would bring financial institutions and casinos into the regime, while the second stage would incorporate non-financial businesses and professions.

INSOLVENCY LAW REFORM

The Insolvency Law Reform Bill was passed by Parliament on 26 October 2006 and was assented to on 7 November 2006.

The Bill was passed as three separate pieces of legislation: the Insolvency Act 2006, the Companies Amendment Act 2006, and the Insolvency (Cross Border) Act 2006.

- The Insolvency Act 2006 replaces the existing Insolvency Act 1967 and includes the reforms to personal insolvency law including the introduction of the no asset procedure.
- The Insolvency (Cross-Border) Act 2006 implements the model law of cross border insolvency adopted by the united nations commission on international trade law.
- The Companies Amendment Act 2006 introduces the new phoenix company prohibitions, the amendments to the voidable transaction provisions and the introduction of the voluntary administration procedure.

The introduction of the voluntary administration procedure is significant. The most notable aspect of voluntary administration regime for creditors is that the administration

Legislation continued ...

brings with it an automatic moratorium for the duration of the administration, which prevents a secured creditor from enforcing security over the company's property. The purpose of the moratorium is to provide the company with "breathing space" during which it can continue to operate, without interference, while the administrator can take stock of the situation and decide what to do.

However, secured creditors who hold charges over the whole, or substantially the whole, of the company's property can effectively frustrate or block the administration by choosing to enforce their security within 10 days after being notified of an administrator's appointment - this is referred to in the Act as the "decision period". This constitutes the most important exception to the moratorium under the procedure. There is also an obligation on administrators to notify substantial secured creditors of their right to enforce.

BUSINESS TAX REVIEW DISCUSSION DOCUMENTS

Pursuant to the ongoing Business Tax Review, on 8 November 2006 the Minister of Finance and the Minister of Revenue jointly released issues papers on skills training

tax credits, market development tax credits, and research and development tax credits. The three issues papers consider how such tax credits might work in practice should they be adopted.

The discussion documents are available at www.taxpolicy.ird.govt.nz.

Submissions on the issues papers close on 1 December 2006.

SNIPPETS

MARKET MANIPULATION IN AUSTRALIA

The 2006 issue 18 of the *CHH Australian Corporate News*, contains the following article of interest:

- **Market rigging - the process and the penalty.**
This article is adapted from Brian Egan's monthly Corporate & Commercial Law Update April 2006, and reports on a successful prosecution in Western Australia in *Brown v R [2006] WASCA 145*. That case gives a glimpse into the world of market manipulation and the approach of the court in sentencing in Australia.

Market manipulation is a serious offence under the Australian Corporations Act 2001. However, successful prosecutions are rare because market manipulation is an offence that is hard to detect, and time-consuming and expensive to prosecute. This makes the recent successful prosecution of Brown for this offence all the more interesting.

In this case, Brown owned shares in a company called Astron, and also had interests in other companies that held shares in Astron. By instructing several brokers at one time to trade in Astron shares, he created the appearance of active competition in a thinly traded stock. After one of the brokers became suspicious of his actions, the defendant's actions were investigated by ASIC and he was consequently found guilty of market manipulation and fined \$30,000. Brown appealed to the West Australian Court of Appeal, where his appeal was dismissed.

The Court of Appeal commented on the elements of the offence and noted that:

- in order to establish the offence, the prosecution has to prove the person intended to do the act, and was (at least) reckless as to whether or not it would create a false or misleading appearance;
- the section creates only one offence of market

Snippets continued ...

manipulation (not a hierarchy of several offences as Brown tried to argue), but it can be committed in various ways; and

- the sentence imposed on Brown was on the lenient side given that it was open to the sentencing judge to impose a term of imprisonment.

INTERNATIONAL FINANCIAL REPORTING STANDARDS IN NEW ZEALAND

The October 2006 issue of the *Chartered Accountants Journal* contains the following article of interest:

- **The impact of adopting NZ IFRS** by Alastair Boulton and Lay Wee Ng. This article analyses the results of a survey carried out by the Securities Commission on a number of issuers with FRS-41: *Disclosing the impact of adopting New Zealand equivalents to International Financial Reporting Standards*. The article discusses the required disclosures to be made under the FRS-41 about the impact of adopting

New Zealand International Financial Reporting Standards (NZ IFRS) and reflects on how the 45 issuers reviewed by the Securities Commission made those disclosures.

The article considers in particular the overall levels of compliance with the requirements of FRS-41 and the level of detail provided by issuers in making disclosure. It notes that some issuers gave detailed information on the background to adoption of NZ IFRS as well as the management of their transition to NZ IFRS. However, the authors agree with the Securities Commission that the overall level of disclosure was disappointing.

The authors conclude that the adoption of NZ IFRS is a significant event for many issuers and that it is imperative that important information in accordance with FRS-41 relating to the transition to NZ IFRS be communicated to users of financial statements. They encourage issuers to look more closely at the quality of their disclosures prior to adopting NZ IFRS.

Snippets continued ...

INTERNATIONAL FINANCIAL REPORTING STANDARDS IN AUSTRALIA

ANTI-MONEY LAUNDERING

The August/September 2006 issue of *InFinsia* contains the following articles of interest:

- An article entitled **AIFRS - a work in progress** by Geoff Wilson and Andrea Waters. This article provides a comparison between the attitudes of financial analysts prior to the transition implementation, and one year into transition of Australia's equivalent of International Financial Reporting Standards ("**AIFRS**").

The article discusses the 2006 survey of Australian financial analysts commissioned by KPMG to determine their familiarity with and understanding of AIFRS. The 2006 survey replicated an earlier survey of the same nature, conducted in December 2004.

The article argues that while financial analysts reactions to AIFRS were mixed, the positives that could be drawn from the 2006 report included the increased quality of company communication, and reduced fears of market volatility, due to the implementation of AIFRS.

The article paints the 2006 survey results in an optimistic light, suggesting that despite beliefs that AIFRS produces more complex and opaque financial statements than previously, the statements' complex nature is not due to AIFRS, but rather to the growing complexity of business operations and transactions.

The article concludes that financial analysts respond positively to transparent and detailed briefings on the impact of AIFRS, however many Australian companies have not yet briefed their analysts on the new regime.

- An article by Owain Stone and Rob Walsh entitled **AML - making the most of a risk-based approach**. The article discusses the risk-based approach adopted by the Australian Government's

Snippets continued ...

revised exposure draft Anti-Money Laundering and Counter-Terrorism Financing (AML/CTF) Bill and draft AML/CTF rules, released on 13 July 2006.

The article commends the Government's risk-based approach where organisations are able to design programmes for mitigating AML/CTF that are appropriate to the organisation's circumstances. The Bill emphasises that organisations should use their resources to alleviate the products, customers and distribution channels that pose the greatest risks.

Money laundering risk is characterised as another business risk that should be integrated into the firm's risk management structure. Workshops with employees and AML teams have been suggested as an effective tool with the focus being on identifying risks and finding mitigating controls throughout the business.

The concluding remarks note that an effective risk-based approach to AML will give an organisation a competitive advantage in attracting business.

INSIDER TRADING REGIMES IN AUSTRALIA AND NEW ZEALAND

The September 2006 issue of the Company and Securities Law Journal contains an article by Keith Kendall and Gordon Walker entitled **Insider trading in Australia and New Zealand: Information that is "generally available"**.

- In this article, Kendall and Walker conduct a comparative analysis of the insider trading regimes in New Zealand and Australia, focussing in particular on the carve-outs that apply to the definition of "inside information" in both regimes (in Australia, when information is "generally available" and in New Zealand, when information is "publicly available").

The article looks at the changes to New Zealand insider trading law contained in the Securities Legislation Bill 2004 (which was still before Parliament when the article was written, but was assented to on 24 October 2006). Kendall and Walker view the "current" New Zealand insider-trading regime (ie the regime in place prior to 24

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October 2006) as a comprehensive failure that the Securities Legislation Bill 2004 intends to rectify. Consistent with the Closer Economic Relations Agreement between Australia and New Zealand, which is designed to coordinate business laws in the two countries, the new regime expressly adopts a number of concepts from Australian insider trading law. One of these concepts is the Australian concept of information that is "generally available".

Kendall and Walker go on to analyse the extent to which this change is a departure from the current regime. They conclude that the "generally available" concept is an extension of the current "publicly available concept" and that it is a slight improvement from its Australian equivalent in terms of certainty. However, they note that a number of the problems that Australian courts face remain unsolved in New Zealand's adoption of the "generally available" concept. Finally, they conclude that a consequence of the harmonisation in this area is that New Zealand and Australian courts will need to pay closer attention to each other's decisions.

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

www.russellmcveagh.com

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