

RUSSELL McVEAGH

BANKING LAW UPDATE

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LEGISLATION

Amendments to minority buy-out rules in the Companies Act

The Companies (Minority Buy-Out Rights) Amendment Bill was introduced on 7 November 2007 and, if enacted, will amend the Companies Act 1993 to provide minor shareholders in companies with increased protection. The Bill provides that minor shareholders who have unsuccessfully opposed a fundamental change in the company's structure will be able to require the company to purchase their shares at fair value. This is technically the case already under the Companies Act, but the current provisions contain no guidance as to how a fair price for the shares should be arrived at.

The Minor Shareholders Bill proposes that the price of shares in a minority buy-out will be calculated from the date that the company gives the shareholder notice agreeing to buy back the shares, but the valuation will be adjusted to disregard any change attributable to the event triggering the buy-out. The Bill also clarifies and expands the powers of an arbitrator in a minority buy-out.

Income Tax Act 2007 enacted

The Income Tax Act 2007 was enacted on 1 November 2007. The new Act is the final stage in the rewrite of New Zealand's tax legislation, which has been in progress for around 15 years. The new Act rewrites existing legislation; it does not make substantive amendments. The new Act will apply to income derived from the 2008-2009 income year.

Registration of non-bank deposit takers

The Reserve Bank of New Zealand Amendment Bill (No 3) was introduced on 21 November 2007. The Bill partially implements one of the initiatives in the government's ongoing review of financial products and providers (see the June issue of Banking Law Update for the most recent round of documents), that is, the proposal that all deposit takers (ie, not just registered banks) be required to be licensed by the Reserve Bank.

Deposit takers are defined as persons who offer debt securities to the public and are in the business of borrowing and lending money or providing other financial services.

Legislation Continued...

Key proposals in the Bill are:

- most deposit takers will be required to obtain a credit rating from an approved rating agency; and
- regulations may be made that:
 - o require deposit takers to maintain a minimum amount of capital;
 - o limit related party exposures;
 - o require deposit takers to maintain a capital ratio;
 - o require deposit takers to meet specified liquidity and risk management requirements; and
 - o prescribe corporate governance standards for deposit takers.

Under the current law, the main supervisors of non-bank deposit takers are the trustees of trust deeds relating to the debt instruments that non-bank deposit takers issue. The Bill imposes further reporting and attestation obligations on trustees to help the Reserve Bank perform its role as the

industry's prudential regulator. The Reserve Bank, trustees, and the Securities Commission will be responsible for different aspects of the regulation of deposit takers.

The Bill implements only part of the new regulatory framework for deposit takers, being those matters for which prudential regulations may be prescribed. Separate legislation, to be introduced next year, will implement licensing requirements and "fit and proper person" requirements for the directors and senior managers of deposit takers.

SNIPPETS

POSSESSORY SECURITY INTERESTS: SPECIAL RULES TO APPLY TO INVESTMENT PROPERTY UNDER THE PROPOSED PERSONAL PROPERTY SECURITIES LAWS

The September 2007 issue of the *Journal of Banking and Finance Law and Practice* contains an article entitled **Possessory security interests: special rules to apply to investment property under the proposed personal property securities laws** written by Craig Wappett and Angela Flannery.

The article summarises the last of the three discussion papers issued by the Australian federal government in relation to its overhaul of Australia's personal property security regime. This third paper outlines the special regime for "possessory" security interests which is to be largely similar to New Zealand's. Some core concepts of the possessory security regime are discussed, namely: the definition of investment property (a subject of "possessory security interests") and the rules regarding "perfection" of an interest by possession and by control, as well as the suitability of these rules.

STUCK ON THE RUNWAY

The 2007 October Issue of the *Institute of Finance Professionals NZ Inc. Journal* contains an article by Zilla Efrat entitled **Stuck on the runway**. This article examines why futures contracts have failed to take off, despite some initial interest, since they were first listed on the NZX 15 Index three years ago.

The New Zealand Exchange (**NZX**) signed a deal with the Sydney Futures Exchange (**SFE**) Corporation in September 2003 to enable the NZX to provide a range of futures and options contracts to New Zealanders, by listing the equity on the SFE. This was a way of NZX avoiding the significant investment required to build its own market infrastructure and of gaining instant access to SFE's global participant base. At the time the deal was announced, the NZX said it expected liquidity in the underlying assets would improve.

A number of problems have since been identified which may have contributed to the lacklustre performance of futures contracts on the NZX 15 Index. These include:

- The cost for organisations in New Zealand to connect to the SFE from a technical perspective;

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- Securities lending rules that result in tax liabilities for those trading in derivatives; and
- Most significantly, liquidity issues due to the NZX 15 being a small market. Although liquidity in the Top 10 has generally been increasing, all stocks in the underlying basket of stocks need to be liquid for the NZX 15 Index to work.

LEGAL POSITIONING OF REIMBURSING BANK

Issue 10 of the *Journal of International Banking Law and Regulation* contains an article by E.P Ellinger entitled **Legal positioning of reimbursing bank**.

A bank which pays out money at the instruction of another bank is entitled to claim reimbursement. This article looks at the situation where reimbursement occurs through a third party bank ("**reimbursing bank**").

Issues around reimbursement through a third party bank arise regularly in letter of credit transactions. However, a claiming bank may also be authorised to draw on a reimbursing bank in respect of financial packages, such as substantial deals respecting goods, equities or securities.

Currently, there are two sets of guidelines that help determine the legal position of reimbursing banks. These are the *Uniform Rules for Bank-to-Bank Reimbursements Under Documentary Credits* (URB) and article.13(b) of the *Uniform Customs and Practice for Documentary Credits* (UCP-600).

This article discusses the legal position of the reimbursing bank in relation to the issuing bank (ie the bank that issues the instruction). The author notes that the relationship "is an instance of agency created by an express conferment of authority". The article also looks at various issues that arise in this relationship and how the guidelines deal with these issues.

Also examined in this article is the relationship of the reimbursing bank with the claiming bank (ie the bank that makes the payment). The author notes that although a reimbursement authorisation does not, in itself, confer any rights on the claiming bank, the URB enables the reimbursing bank to confer a right on the claiming bank by issuing a "reimbursement undertaking". Under art.9(b), such an instruction is irrevocable.

The author also discusses the standards for reimbursement claims and finally looks at exemption clauses and how the

Snippets continued ...

effect of provisions in the guidelines is to shift liability to the issuing bank.

THE DIRECTOR'S "FIDUCIARY" DUTY OF CARE AND SKILL: A MISNOMER

REMOVAL OF PUBLIC COMPANY DIRECTORS IN AUSTRALIA

The September 2007 issue of the *Company and Securities Law Journal* Contains two articles of interest.

- The first is an article by William Heath entitled **The director's "fiduciary" duty of care and skill: A misnomer**. This article considers whether a company director's equitable duty of care and skill should be classified as a "fiduciary duty".

In *Permanent Building Society (in liq) v Wheeler* the full court of the Supreme Court of Western Australia concluded that a "director's duty to exercise reasonable care, though equitable (as well as legal) is not a fiduciary obligation". This doctrine has been strongly criticised by Heydon J of the High Court.

The article demonstrates that the principles behind the Wheeler doctrine, and Heydon J's criticisms of it, make untested claims about the origins and development of the director's equitable duty of care and skill. The article then goes on to analyse these origins and development and concludes that the Wheeler doctrine is correct.

The director's equitable duty of care did not originate from fiduciary principles in trust law, fiduciary concepts of trust and confidence, or a position of disadvantage or vulnerability on the part of the company which would make it a fiduciary duty. Instead, the duty of care evolved from the common law principles underpinning the duty of diligent management owed by a gratuitous bailee. The author believes there is strong evidence that the development of the duty of care in equity was an example of equity following common law rather than the manifestation of a unique fiduciary principle. Accordingly the author concludes the director's equitable duty of care is not fiduciary.

- The second is an article by Stephen Knight entitled **The removal of public company directors in Australia:**

Snippets continued ...

Time for change? The article examines the methods of director removal in Australia and compares the Australian position to other countries, including New Zealand.

The Australian Securities and Investment Commission (“ASIC”) takes the view that the only method by which members of a public company can remove a director is the shareholder voting power contained in section 203D of the Corporations Act 2001 (Cth) (other non-member methods are resignation, or banning by either ASIC or court order.) Section 203E expressly prohibits the removal of a director by the other directors of the company.

However, case law has turned up two situations where this can occur, though neither case has been tested at the highest levels of the court system. The first arose in *Maloney v NSW National Coursing Association* [1978] 1 NSWLR 161. Here, the articles of the association held that committee members needed to be members of the association. As a result of disciplinary matters, the committee resolved to revoke the membership of a committee member and accordingly the member had to leave the committee as well. The court found that this indirect consequence of the board resolution was not a

violation of the then equivalent to section 203E.

The second situation comes from *Quinn v FBG Superannuation Ltd* [1998] VSC 173, where there was a ‘self-executing’ rule in a company constitution. Under such a rule, if a certain set of circumstances occurs (for example, if a certain number of directors meetings is missed without explanation), a director is removed automatically, with no board action necessary.

For comparison, the author notes other countries adopt more flexible positions. In New Zealand, a company constitution may in fact remove the ability for a director to be removed by shareholder vote but on the other hand allows a rule for removal by board resolution. The UK keeps mandatory removal by shareholder vote, but similarly allows for additional methods to be contained in the company constitution. In the most common state for company incorporation in the United States, Delaware, shareholder voting has two additional twists. The first is that a ‘cumulative’ voting system may be used, the effect of which is to improve minority shareholder representation, and the second is that a company may designate itself as ‘classified’ with the directors elected

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in 'classes' which come up for election in different years, staggering the election process.

The author believes Australian boards should have the power to remove fellow directors. In their view shareholders would not be adversely affected, noting alternative courses of action available to shareholders if they felt their interests were being oppressed. Additionally, as board resolutions only need a simple majority, there is no justification for a board to get rid of a director simply for not agreeing so directors would still feel free to adopt contrary positions, not just 'toe the line'.

ANTI-DIRECTOR LAW AND STANDARD OF CARE

The October 2007 issue of the *Company and Securities Law Bulletin* contains an article by Stephen Franks entitled **Anti-director law and standard of care**.

The article begins by canvassing the reported findings of a group inspired by the Harvard *Rafael La Porta* country comparison study which highlighted the importance of secure property rights and effective courts.

The author next addressed an association between market strength and what is known as "anti-director" law which is defined as the minority protection and constraints on director autonomy. The author is critical of the potential liability of directors under New Zealand's securities law and the necessity of precautions such as due diligence procedures to offer some form of protection against the erosion of limited liability.

In conclusion, the author proposes that New Zealand should consider a change in the current liability prescriptions under our securities law and the analogous Companies Act provisions. The author suggests that instead of liability being attributed for failure to have grounds to believe all published statements, that instead liability should be for failure to act on any information that warned that a key assumption or belief may be unfounded.

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ASCERTAINING THE CRIMINAL LIABILITY OF A CORPORATION

The September 2007 issue of the *New Zealand Business Law Quarterly* contains an article by Stephanie Earl entitled **Ascertaining the criminal liability of a corporation.**

The article discusses the manner in which companies are held liable for criminal behaviour based on various theories of attribution. The author looks to other jurisdictions for guidance on how the issue is addressed internationally and whether reform is required to adequately capture corporate guilt in the New Zealand legal system.

The current New Zealand approach to ascertaining corporate liability (the 'derivative basis') attributes the state of mind of a company to the appropriate individual agents of that company in light of the relevant statutory provision. In opposition, the second theory (the 'organisational basis') views the company as a distinct entity which can be liable of itself and having an existence independent of its members. The author draws from the leading New Zealand authority (*Meridian Global Funds Management Asia Ltd v Securities Commission* [1995] 3 NZLR 7) in which Lord Hoffman formed the opinion that 'there is in fact no such thing as

the company' and accordingly, the liability of a company is dependent on applicable rules of attribution to individuals. The key reason for the rejection of the organisational basis of corporate liability is the fact that corporate activity is always the product of human agency.

The article proceeds to review other jurisdictions' treatment of corporate criminal liability. In Australia the legislature has adopted a method of determining corporate guilt whereby fault will exist on the part of the body corporate if it expressly, tacitly or impliedly authorised or permitted the commission of the offence. This includes a reference to 'corporate culture' whereby an attitude, policy, rule or course of conduct existing within the body corporate will satisfy the mental element of the offence. In this same vein, the United Kingdom Law Commission, in the context of a review of 'corporate manslaughter' on the basis of management failure, stated its objective the removal of the requirement under the present law to identify individuals within the company whose conduct is to be attributed to the company itself.

On the matter of attribution the article notes that the dependence of corporate liability on individual liability is one of the most significant deficiencies of the derivative

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approach. To counter this, the author introduces the theory of "aggregation", where a corporate may be found to be at fault (despite no individual liability) through the action of collective agents. Despite concerns having been raised internationally about the doctrine of aggregation it has gained some acceptance as a potential solution to the abovementioned problem of individual attribution.

The article notes the key drawback to the current New Zealand (*Meridian*) approach being its uncertainty as a result of tailoring liability to the particular statutory provision. The author proposes the obvious and best solution to this problem would be for legislation to be drafted with an indication of how a body corporate is to be liable under its provisions.

The article concludes that there is room for development in corporate criminal liability. However organisational liability is not the way forward and any development to the law should occur on a principled basis.

LAW REFORM IN NEW ZEALAND: TOWARDS A TRANS-TASMAN INSOLVENCY LAW?

The September 2007 issue of the *Insolvency Law Journal* contains an article by David Brown entitled **Law reform in New Zealand: Towards a trans-Tasman insolvency law?**

This article examines New Zealand's recent insolvency law reform package (which covers corporate insolvency, personal insolvency and cross-border insolvency) and in particular analyses the extent to which the reforms, in the context of existing trans-Tasman commercial relations and initiatives, deliberately bring Australian and New Zealand law closer together.

The article contains a summary of the reasons for the new insolvency laws and examines the changes against New Zealand's political and economic environment since 1999 and against government initiatives towards a trans-Tasman coordination of business law. In doing so the article looks at all the key aspects of the insolvency law reform, including the new no asset procedure for personal insolvency, the amendments to the voidable transaction provisions, the new voluntary administration regime, the new phoenix company provisions, changes to priority debts and New Zealand's implementation of the Model Law on cross-border insolvency.

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

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