
LEGAL UPDATE ON BANKING AND COMMERCIAL LAW

Material adverse change clauses and absolute discretion

Power of mortgagees to acquire mortgaged properties - recent High Court consideration of Section 200(3)(d) of the Property Law Act 2007

HLH Equity Trading Limited v White - Court considers whether an individual's role amounts to that of a director under the Securities Act

Takeovers Panel finalises its policy on upstream acquisitions

Cape Town Convention receives Royal Assent

Submissions sought in response to proposed Securities Law Reform

All reasonable endeavours?

Focusing on productivity

Image rights and restraint of trade

Material adverse change clauses and absolute discretion

A recent Australian case, *Brighten Pty v Bank of Western Australia*, involved a material adverse change (MAC) clause specifying an event of default if: "In the Lender's opinion there is a material adverse change in the obligor's financial condition". When a default notice was issued the borrower sought an injunction to prevent the appointment of a receiver. The court dismissed the application, and commented on MAC clauses that confer an absolute discretion on the lender to assess whether it has been triggered. By analogy with trustees, the court took the view that the bank's assessment would be valid so long as the decision is not made in bad faith, arbitrarily or capriciously.

Even though such a test is helpful for lenders, caution will still be required when taking enforcement steps based on a MAC event of default. A lender should turn its mind to the matter and actually form the necessary opinion that an event of default has occurred (rather than a mere possibility), taking into account the specific words of the clause. This view should be based on information of which the bank has actual knowledge and can rely on as evidence if the decision is later challenged.

See court decision [here](#).

Power of mortgagees to acquire mortgaged properties - recent High Court consideration of Section 200(3)(d) of the Property Law Act 2007

Condon v Southland Building Society (HC, Invercargill, CIV 2010-425-000020, 13/04/10), Lang J

As noted in our commercial and banking law update in July 2009, section 200(3)(d) is a new section in the Property Law Act 2007. The section reflects an important change to the previous law in permitting a mortgagee to acquire a mortgaged property if it obtains the approval of the Court before it does so. Previously, a mortgagee was permitted to acquire a mortgaged property only if it did so at an auction conducted by the Registrar of the High Court.

The Property Law Act 2007 does not give any guidance as to the circumstances in which such an order will be granted. The recent case of *Condon v Southland Building Society* contains a useful discussion by the High Court of the application of section 200(3)(d). In particular, the High Court considered 2 cases in which the application of the section was uncontested as well as one where it was contested. Justice Lang said the primary principle to be taken from the

considered authorities was that the Court would permit a mortgagee to acquire the mortgaged property only when it was satisfied that the mortgagee's price reflected the best price reasonably attainable at the time of acquisition.

The case relates to a successful application by Southland Building Society (**SBS**) for an order permitting it to purchase properties in respect of which it held registered mortgages. Upon default by the mortgagors SBS took steps to sell the properties using its powers of sale as mortgagee and over a period of 2 years extensively marketed the properties for sale by auction, tender and private treatise. Justice Lang made an order approving SBS's purchase of the mortgaged properties at a price equal to the highest cash offer received by the mortgagee. That offer had been refused at the time and was later reduced when the properties were passed in at auction.

The consideration by the High Court of previous applications made under section 200(3)(d) provides useful guidance to mortgagees who may wish to acquire mortgaged property when exercising their power of sale. In particular, mortgagees should ensure they make reasonable efforts to find a buyer willing to pay the best price reasonably obtainable for the property before making any application under section 200(3)(d). Mortgagees should also be aware that the Court will only permit a mortgagee to acquire a mortgaged property when it is satisfied the mortgagee is prepared to pay the best price reasonably obtainable. Mortgagees should not consider the use of section 200(3)(d) as a simple exercise which will be implemented as a matter of course by the Courts.

***HLH Equity Trading Limited v White* - Court considers whether an individual's role amounts to that of a director under the Securities Act**

The plaintiffs in this case all invested money in property projects promoted by the first and second defendants. The projects were undertaken in Timaru, Henderson and Gisborne using trading trusts. The investors received "debenture stock" in the trading trusts in return for their money.

The investments all turned out to be disastrous. The 2 trustee companies of the trading trusts went into liquidation and the first defendant was declared bankrupt. The plaintiffs in this case sought redress against the second defendant, Mrs White, on the grounds that the Securities Act 1978 (the **Act**) applied to each of the investments made by the plaintiffs and therefore the allotment of the "securities" (being the debenture stock) was void because the defendants did not register a prospectus or produce an investment statement in relation to those securities. Justice Lang agreed and accordingly, each allotment was void and (by virtue of section 37(6) of the Act) the issuer of the securities and all its directors were liable to repay the subscriptions.

Mrs White was an appointed director of the company that was responsible for the developments at Timaru and Henderson and was therefore found to be personally liable for repayment of the investments for the Timaru and Henderson projects. She was fully involved in the operations of those projects and knew they were receiving money from investors. Justice Lang stated that she had a responsibility to know the requirements of the Act and an obligation to ensure that if the allotments turned out to be void, that the company would be in a position to repay its investors.

However, Mrs White was never a director of the company responsible for the Gisborne development. The Court examined the definition of director under the Act and found that the Act was clearly intended to allow persons who were not formally, or validly appointed as directors under the Companies Act 1993, to be regarded as directors for the purposes of the Act. In this case, the Court found that there were 3 factors that meant Mrs White could not be liable as a director for the Gisborne company:

- The defendants had deliberately chosen for the first defendant to be the sole director of the Gisborne company
- There was evidence that Mrs White did not make any decisions on behalf of the Gisborne company
- The first defendant was solely responsible for all written communications with investors in relation to the Gisborne project.

Although in this case Mrs White was not found liable as director for a company for which she was not a formally appointed director, the case shows the willingness of the courts to examine the essence of an individual's role to determine if the obligations imposed by the Act on directors of issuers will apply to that individual, whether or not they have been formally appointed as a director.

Takeovers Panel finalises its policy on upstream acquisitions

In a previous **legal update**, we summarised the Takeovers Panel's preliminary investigation into ways of dealing with the implications of takeovers of New Zealand companies that are a consequence of upstream acquisitions of both foreign and domestic holding companies. The Panel has now settled on a policy for dealing with the impacts of the Takeovers Code (**Code**) on upstream acquisitions, the details of which are summarised below and set out fully in the Panel's recent **Guidance Note**.

In the Guidance Note, the Panel confirms that it will normally grant an unconditional exemption from the application of the Code for an upstream acquirer that will become the controller of more than 20% of the total voting rights in a downstream Code company as a result of the proposed upstream acquisition. However, an unconditional exemption will only be granted if the upstream target is listed on a recognised exchange (such as the NZX or a foreign exchange in a jurisdiction with a comparable level of investor protection), and the "purpose test" is satisfied.

In order to satisfy the "purpose test", the upstream acquirer must prove that acquiring control of the voting rights in the downstream Code company cannot reasonably be regarded as a significant purpose of the upstream acquisition (**Purpose Test**). If the value of the interest held by the upstream target in the downstream Code company is less than 25% of the enterprise value of the upstream target, the Purpose Test will, on its face, be satisfied (**Value Test**). However, the Value Test is only a proxy for the Purpose Test and may therefore be disregarded if the Panel considers that the Purpose Test is not in fact satisfied, or vice versa.

If an unconditional exemption is not possible, the Panel has confirmed in the Guidance Note that it is still possible for a conditional exemption to be granted. A conditional exemption will be subject to the condition that the upstream acquirer elects and undertakes to either:

- Decrease the upstream target's holding or control of securities carrying voting rights in the downstream Code company to 20% or less by no later than six months after the upstream acquisition becomes unconditional, and ensure that pending the decrease the upstream target does not exercise any voting rights in the Code company above the permitted 20% level
- Make a follow-on offer (subject to several additional conditions itself) for the rest of the shares in the downstream Code company no later than 60 days after the upstream acquisition becomes unconditional.

The Guidance Note provides welcome direction from the Panel on an issue that has been the subject of considerable debate since BG Group plc's proposed takeover of Origin Energy, a majority shareholder in NZX listed Contact Energy.

Cape Town Convention receives Royal Assent

In our **June 2010 update**, we noted that the Civil Aviation (Cape Town Convention and Other Matters) Amendment Bill had been introduced into Parliament. The Bill was passed through all 3 readings in Parliament without amendment under urgency on 23 June 2010 and was given the Royal Assent on 30 June 2010. The proposed law will make New Zealand party to the Convention on International Interests in Mobile Equipment (the **Convention**) and the associated Protocol to the Convention of International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment (the **Protocol**).

The Civil Aviation (Cape Town Convention and Other Matters) Amendment Act 2010 implements a significant change in the law relating to the financing of aircraft. New Zealand will become part of an international system to protect commercial security interests in mobile aircraft equipment which improves certainty for investors in high-value mobile equipment such as aircraft, thereby reducing financing costs for aircraft operators.

Consequential amendments are set to be made to various enactments, including the Property Law Act 2007 and the Personal Property Securities Act 1999, to bring them into line with the provisions of the Cape Town Convention.

The Convention and Protocol will come into force in New Zealand on 1 November 2010.

Submissions sought in response to proposed Securities Law Reform

The Ministry of Economic Development has released a discussion paper proposing sweeping reforms that will affect the way most financial products are offered to the public. The discussion paper follows on from the work of the Capital Market Development Taskforce which reported late in 2009 and discusses possible reforms intended to improve safeguards for non-professional investors.

To view our comprehensive update on the discussion paper, please click [here](#).

All reasonable endeavours?

The precise meaning of "reasonable endeavours", "all reasonable endeavours" and, to a lesser extent, "best endeavours", has long been a matter of some uncertainty. This perennial question has again been considered in a recent decision of the High Court of England (*CPC Group Limited v Qatari Diar Real Estate Investment Company* [2010] EWHC 1535 (Ch)) and provides an opportunity to recap on these commonly used but often misunderstood contractual phrases.

The case concerned a sale and purchase agreement in which the defendant purchased the plaintiff's interest in a joint venture company. The purchase price comprised an initial sum and a deferred consideration that depended mainly on future progress being made in obtaining planning permission for the joint venture company's proposed development. The defendant agreed to "use all reasonable but commercially prudent endeavours to enable the achievement of the various threshold events" for the payment of the deferred consideration. The Judge held that an obligation to use "all reasonable endeavours" was not equivalent to an obligation to use "best endeavours", and that it "does not always require the obligor to sacrifice his commercial interests". On the facts, that interpretation was supported by the words "but commercially prudent", but the Judge's conclusion did not depend on those words being present.

More generally, the meaning of best endeavours has been considered in New Zealand in *Centaur Investments Co Ltd v Joker's Wild Ltd* (2004) 5 NZCPR 675 at [69]. The High Court adopted earlier statements that:

- Best endeavours "do not mean second-best endeavours. ... They do not mean that the limits of reason must be overstepped ... but short of these qualifications the words mean that the [party discharging the obligation] must, broadly speaking, leave no stone unturned"
- A best endeavours obligation requires the obligor to "do all he reasonably can in the circumstances to achieve the contractual object, but no more" - i.e. the obligor does not need to "go beyond the bounds of reason".

There are fewer statements on the meaning of reasonable endeavours or all reasonable endeavours. One commentator has suggested that an obligation to use reasonable endeavours involves making "an honest try" and that "[a]ny financial or practical impediment could justify taking no positive action" (Quentin Lowcay, "'Best Endeavours' and 'Reasonable Endeavours'" [1999] NZLJ 211, 215). Another formulation requires the obligor to balance the "weight of their contractual obligation" to the contracting party against "all relevant commercial considerations" including, for example, the cost of taking the action and the chance of achieving the desired result (*UBH (Mechanical Services) Limited v Standard Life Assurance Company* (*The Times*, 13 November 1986, CA). "All reasonable endeavours" has sometimes been used interchangeably with "best endeavours" or "reasonable endeavours" but is generally thought to be "a middle position between the two" (*UBH (Mechanical Services) Limited v Standard Life Assurance Company*). What is clear is that the requirements of an obligation to use "reasonable endeavours" or "all reasonable endeavours" in any particular case will depend on the circumstances of that case (*Westpac Banking Corporation v Money* [2004] 1 ERNZ 576 (CA)).

It is always preferable to state the obligations of each party to an agreement clearly and unambiguously to avoid dispute if the agreement is breached. However, notwithstanding the uncertainty that prevails, endeavours clauses can be useful from a practical point of view where it is not possible to determine (or reach agreement on) the specific steps that the obligor will be required to take in the circumstances as they develop. In this context, the English High Court decision in *CPC Group Limited v Qatari Diar Real Estate Investment Company*, while not binding in New Zealand, provides useful guidance as to the meaning of "all reasonable endeavours".

Focusing on productivity

The New Zealand Productivity Commission Bill has recently been introduced in Parliament. Its purpose is to establish the New Zealand Productivity Commission which will have the rather lofty goal of "improving productivity in both the public and private sectors in a way that is directed at supporting the overall well-being of New Zealanders."

The government believes the Commission is necessary in the context of New Zealand's current economic challenges which include a regulatory environment that constrains investment and limits growth, research and development expenditure below OECD levels, limits on natural resources, inadequate infrastructure in some areas, and low domestic savings. The Commission is modelled on the Australian Productivity Commission. It will be an independent agency (with 3 to 4 Commissioners) and will provide an alternative source of policy advice on opportunities to significantly improve economic performance. The Commission will undertake productivity related enquiries, reviews and research on a broad range of matters relating to the private and public sectors including matters relating to labour, natural resources including sustainability, management and worker skills, industry including industry development, innovation activity and entrepreneurship, competition, and investment. A copy of the Bill can be viewed [here](#).

Image rights and restraint of trade

A recent English decision highlights the risks in tying down sports figures (or any other celebrity) to long-term agreements regarding their image rights. The English High Court (*Proactive Sports Management Ltd v Rooney and others* [2010] EWHC 1807 (QB)) has held that Wayne Rooney's long-term image rights agreement with his former management company was unenforceable as it was an "unreasonable restraint of trade".

Rooney entered into the image rights agreement in 2003 when he was just 17. The agreement had a term of 8 years and provided for the manager, Proactive, to receive 20% of the gross sum payable under any contract for promotion, endorsement or advertisement involving Rooney. Unsurprisingly, this arrangement proved very successful, for the manager.

The judge held that the agreement imposed substantial restrictions on Rooney's freedom to exploit his earning capacity. The 8 year term was found to be in excess of usual agreements in the market for such agency services, and the doctrine of restraint of trade was held to apply. While the judge recognised that a long-term strategic approach was desirable to develop Rooney's personal brand, Proactive was unable to demonstrate that the length of the exclusive arrangement was reasonable, having regard to the legitimate interests of the parties. This case is a reminder to ensure that any agreement which restrains the commercial rights of an individual must be reasonable as to their terms as well as duration, and should be the product of careful commercial negotiation between the parties.

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