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## LEGAL UPDATE ON BANKING AND COMMERCIAL LAW

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### What are "direct" losses?

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The law in New Zealand as to what will be held to be a direct loss or an indirect loss is unsettled (see our previous [legal update](#) on this issue). However, the recent English Court of Appeal decision of *GB Gas Holdings Ltd v Accenture (UK) Ltd & Ors* [2010] EWCA Civ 912 sheds some light on what may be considered to be "direct losses" for the purposes of a liability exclusion clause.

GB Gas Holdings is an associated entity of British Gas Trading Limited, which supplies energy to consumers. It contracted with Accenture (a consulting and IT company) for the design, installation and maintenance of an IT system (including an automated billing system). There were problems with the system. Many customers were not billed and a large number of "exceptions" (situations in which staff had to intervene manually in processes that should have been automated) created a massive backlog of work. As a result, GB Gas Holdings issued proceedings seeking damages.

The contract excluded liability for (among other things) "any losses, damages, costs or expenses whatsoever to the extent that these are indirect or consequential or punitive".

The Court of Appeal upheld the lower court finding that the following categories of losses were direct losses and so were not excluded by the exclusion clause above:

- Payment of compensation to customers because of billing difficulties and poor customer service, including ex gratia compensation. In the context, it was clear that the billing system was intended to improve customer relations and services and Accenture had assumed responsibility for compensation to customers if the billing system failed to do so
- Payment of increased gas distribution charges. The company was unable to supply meter data for 15% of the gas consumption of its gas customers to its gas suppliers, with the result that the suppliers overestimated consumption. It was argued that these were indirect losses as they arose from contracts outside Accenture's knowledge. However, the Court accepted that these losses arose naturally from the breach of contract and not from the special circumstances of the arrangements with the gas suppliers

- Additional borrowing charges. The Court held that, given the centrality of the billing system to the company's business, the "very likely consequence" of breaches that delayed the issue of bills, or meant that bills were not issued, was that the company would have to borrow to make up for the loss of revenue.

What will and will not constitute a direct loss is context-specific and will depend very much on the factual circumstances. However, this decision does suggest that the English courts (at least) may be moving towards a more expansive view of what losses constitute "direct losses".

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## Open source software licence enforced - kitty has claws

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Many businesses and public sector agencies are attracted to open source software, which are free and can often offer the same or better functionality than proprietary, paid software. However "open source" doesn't mean free of all strings.

Recently in the USA the Software Freedom Conservancy was awarded \$90,000 in damages and nearly \$50,000 in costs for wilful infringement of "GPLv2". Westinghouse Digital Electronics was held to have illegally distributed the Unix software utility "BusyBox" which is made available for public use under the open source licence known as version 2 of the GNU General Public License, or "GPLv2". The GPL allows very wide use of the licensed software free of charge provided the terms of the licence are complied with. If a person does not comply with the GPL then they are not permitted to copy or distribute the GPL licensed software or new copyright works based on that software. Users of GPL software must publish the source code of the individual GPL-licensed components and any modifications that they have made. They must also ship a notice with the product to inform the user of their rights under the GPL and the availability of the source code.

Westinghouse included BusyBox in the firmware for its HDTV products without complying with the GPL licence. Together with the damages and costs awards, Westinghouse has also been ordered to stop shipping product loaded with BusyBox and as part of an associated settlement must hand over all unsold products loaded with BusyBox for donation to charity.

Although it's often free, open source software comes with significant strings. If you don't comply with the requirements of the relevant licence the consequences can be severe.

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## Post-judgment default interest

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Two recent cases (*F M Custodians Limited v Andrew John Patullo And Anor* HC CHCH CIV 2010 409 000684 [4 June 2010] and *Westpac New Zealand Ltd v David Ian Wright* HC AK CIV 2010 404 001023 [11 August 2010]) considered whether creditors can contract to receive post-judgment interest at the rate set out in their contract, or if they can only receive interest calculated at the lower rate (8.4% per annum) allowed under the High Court Rules.

Both decisions confirmed that as long as the relevant contract provides for interest to be paid at a contractual rate both before and after judgment, a judgment creditor is entitled to receive payment of any interest at the contractual rate for the period from the judgment date to the date of actual repayment. In each case, the relevant contracts (loan agreements and mortgage terms and conditions) either specifically provided for interest "from the date of the judgment until the date such sum is paid", or specifically referred to the obligation to pay interest both before and after judgment.

The Court in *F M Custodians* considered whether the decision would have been any different if the contract did not specifically provide for interest following a judgment date, but just referred to interest accruing at the contractual default rate from the date it became due "to the date of actual payment" (i.e. no reference to post-judgment). Although it did not reach a conclusion on the point, it considered that while there is a possible jurisdiction to award post-judgment interest in such situations, "a wise commercial draftsman would, in an interest covenant, include specific reference to the "post-judgment" period".

These principles apply to all commercial contracts, not just loan agreements, and the *F M Custodians* case serves as a useful reminder for creditors wanting to avoid unnecessary complications to ensure that it is clear that the default interest accrues at the default rate after, as well as before, judgment.

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## NZGOAL released - The New Zealand Government Open Access and Licensing framework

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NZGOAL was officially released on 6 August 2010. NZGOAL recommends that State Services agencies should make their copyright works available online for re-use on the most permissive of the "Creative Commons" licences, the Attribution (BY) licence, unless a restriction applies. The Creative Commons BY licence allows anyone to use, copy, adapt and distribute the copyright work for *any* purpose, commercial or otherwise, so long as the author of the original work is credited.

This is a significant step by government in that it recognises that making available copyright works and information held by government departments on a broad, permissive basis is likely to generate economic and cultural opportunities and benefits for the New Zealand public.

NZGOAL is the government's guidance for State Services agencies to follow when releasing copyright works and non-copyright material and data for re-use by third parties. NZGOAL does not apply to the release of personal information or to software.

Currently, copyright works and non-copyright material are made available by State Services agencies on a wide range of terms and there is little standardisation. NZGOAL standardises the licensing of government copyright works for re-use by using "Creative Commons" licences.

The UK government has enjoyed notable success in encouraging innovation by releasing UK government data on similarly open terms through its data.gov.uk website. Data released through that initiative has generated innovative new services and applications such as FixMyStreet.com and FillThatHole.org.uk. FixMyStreet.com uses publicly available mapping data to create a service that the public can use to send information about roading issues to local authorities so that they can meet their statutory duty to maintain roads.

Some of the benefits expected accrue from the adoption of NZGOAL include:

- Creating a greater degree of consistency in licensing practices across the State Services
- Generating creative, cultural and economic opportunities for New Zealanders by allowing the use of government data
- Reducing agencies legal costs in analysing licensing and release issues and drafting licensing agreements
- Aligning New Zealand with other jurisdictions such as the European Union, the United States, and the Australian Federal Government.

Further information on NZGOAL can be found [here](#).

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## Transitional timetable for the Financial Advisers Act

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The new financial advisers regime reached its first set of transitional milestones last month with the opening of the **register of Financial Service Providers** on 16 August 2010. The opening of the register marks the start of the transition to full implementation of the Financial Advisers Act 2008 (FAA) and the Financial Service Providers (Registration and Dispute Resolution) Act 2008 (FSPA):

- From **1 December 2010**, it will be mandatory for providers of financial services (except financial advisers) to register under the FSPA
- From **1 April 2011**, it will be mandatory for financial advisers to be registered under the FSPA, and the FSPA will be fully in force
- From **1 July 2011**, the remaining provisions of the FAA come into force, including the restrictions on who is permitted to provide financial services and the disclosure obligations for financial advisers and brokers which will replace those currently set out in the Securities Markets Act for investment advisers and brokers.

Full details of the transitional scheme for financial advisers are set out in full in the **Financial Advisers Act Commencement Order 2010**.

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## FSPA dispute resolution schemes approved

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Minister of Consumer Affairs John Boscawen has announced that Dispute Resolution Services Limited and the Banking Ombudsman Scheme have been formally approved as financial service dispute resolution schemes under the FSPA. Dispute Resolution Services Limited has been appointed as the reserve scheme under FSPA. There are now 4 approved alternative dispute resolution schemes.

As stated above, from 1 December 2010, it will be mandatory for providers of financial services (except financial advisers) to register under the FSPA and join an approved dispute resolution scheme before they can provide services to retail clients.

For further information, see the [Ministry of Consumer Affairs' website](#).

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## Securities Commission accepts revised draft code of professional conduct for authorised financial advisers

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The Commissioner for Financial Advisers, David Mayhew, has accepted the Draft Code of Professional Conduct for Authorised Financial Advisers (the Draft Code). The first Draft Code was initially rejected in August for inconsistency with the FAA. Under section 86 of the FAA, the Draft Code must provide for minimum standards of professional conduct for authorised financial advisers in the areas of competence, knowledge and skills, ethical behaviour and client care. The Commissioner required the Code committee to revisit 3 provisions of the Draft Code.

Firstly, the non-operative background section was apparently inconsistent with recent changes to the FAA. Secondly, concern was raised that code standard 5 may leave authorised financial advisers and consumers with the impression that the Draft Code endorsed the provision of advice on wholesale products to retail investors where the product provider is not a related party of the adviser. Thirdly, code standard 8 was not clear about when a consumer is receiving personalised advice. The Commissioner's concerns with the first Draft Code appear to have been allayed with the revised Draft Code, as each of these provisions have been amended to address the concerns.

The revised Draft Code has now been forwarded to the Minister of Commerce, Hon Simon Power, for approval. The FAA allows the Minister to review the Code for up to 90 days.

The Commissioner's letter to the Minister of Commerce can be found on the [Securities Commission website](#).

The draft Code of Conduct for Financial Adviser can be found on the [Code Committee's website](#).

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## How do you get an absolute warranty these days?

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Readers may recall our earlier discussions of the High Court and Court of Appeal decisions in *Nine Paddocks v Tasman Liquor Company* HC Invercargill CIV-2008-425-000354, 24 July 2009 (see our [November 2009 legal update](#)) and *Tasman Liquor Company v Nine Paddocks & Jones* [2009] NZCA 593 (Ellen France, Gendall and Harrison JJ) (see our [February 2010 legal update](#)).

These decisions held that a disclosure warranty not expressly qualified by reference to the vendor's knowledge (a so-called "absolute" warranty) was implicitly so qualified.

A similar outcome has also arisen in the UK Court of Appeal's decision in *Macquarie Internationale Investments v Glencore UK Ltd* [2010] EWCA Civ 697, where it considered the meaning of a "true and fair view" warranty regarding a company's financial position.

The Court was required to consider whether there had been a breach of warranty in a sale agreement which provided that accounts gave a "true and fair view of the assets and liabilities". In fact, the target company had an unknown, and not reasonably discoverable, liability of GBP2.4m as a result of undercharging by a supplier. The liability was only discovered after completion when the supplier discovered and invoiced the charges. As the overall purchase price was only GBP5,551,000, this appears significant, and had the issue been known about prior to signing, we expect it would have certainly reduced the purchase price agreed.

The warranties in question contained statements as to the manner in which the relevant accounts had been prepared (e.g. in accordance with relevant accounting standards) and (separately) that the accounts give a true and fair view. The purchaser argued that even though the process was in accordance with the relevant accounting standards, the outcome of that process (which is what ultimately mattered to them) did not present a true and fair view and there was therefore a breach of warranty.

The vendor argued, and the court effectively held, that if the accounts are prepared in accordance with the relevant accounting standards, then they are bound to present a true and fair view of assets and liabilities. There appeared to be some implication that the warranties as to process implicitly qualified the warranties as to actual position.

Both the *Nine Paddocks* case and *Macquarie* are arguably very unfair on the purchaser, in that the courts are reading down what appear to be absolute warranties so that they are implicitly qualified by reference to knowledge. This is despite the fact that most of the time that is spent negotiating warranties is explicitly spent on the very question of whether particular warranties should be given on an absolute basis or qualified by knowledge. The vendor in each case could have easily protected themselves by simply qualifying the warranty to their knowledge, but did not do so, probably because after extensive negotiation absolute warranties were agreed.

It should be possible for the parties to freely agree on an allocation for "unknown" or "unknowable" risks, but decisions such as these make this harder. As a result of such decisions, purchasers that want to be certain that an absolute warranty truly is absolute, will likely need to insert a rule of interpretation that warranties which are not qualified by knowledge are intended to be absolute and to capture circumstances which are not known, even if not capable of being known. Accounts warranties may need to make it clear that what matters for a "true and fair view" is the substantive outcome, not the process that was followed to prepare the accounts.

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## Update on ISP liability

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The Commerce Select Committee is currently considering the Copyright (Infringing File-Sharing) Amendment Bill. This Bill repeals section 92A of the Copyright Act 1994 with the goal of providing a fair and effective enforcement regime for unauthorised sharing of copyright material on the Internet. The original section 92A was inserted by the Copyright (New Technologies) Amendment Act, but not brought into force due to public concerns that the section would be unworkable.

The Bill proposes a three-stage notice procedure which is intended to stop infringing file-sharing through public education and deterrence. However, the regime will also impose significant compliance obligations on internet service providers (ISPs). There are a number of issues yet to be resolved and it is not clear whether the proposed regime will be workable and effective in practice.

- Once infringement is detected, a first notice (detection notice) is sent by the copyright holder via the ISP. This will include educational information and inform the account holder that further infringement activity will be logged by their ISP
- The second and third notices (the warning notice and the enforcement notice, respectively) will contain a list of the alleged infringements that the ISP has logged and inform the account holder that the copyright holder may take enforcement action once the third notice is received.

In respect of each notice stage, timeframes (quarantine periods) are established to allow the account holder to remedy the alleged infringement or dispute the notice. If an account holder receives 3 notices, the copyright owner may either apply to the Copyright Tribunal for compensation of up to NZ\$15,000 against the account holder, or apply to the District Court for an order requiring the ISP to suspend the account holder's internet access for up to 6 months.

The latter remedy, particularly, continues to generate controversy. Other key issues include:

- Whether the definition of ISP may catch entities that are not able implement the regime and should not reasonably be classed as ISPs
- Possible inconsistency between the processes in the proposed section 92A and the existing parts of section 92
- The fees (to be set by regulations) that copyright owners will be required to pay in respect of each infringement notice to meet costs of the ISPs for enforcing the regime

- What evidence will be required by the Copyright Tribunal to establish infringement of copyright.

The Commerce Select Committee is due to report back on the Bill by 22 October 2010.

While the Bill may be the cause of some concern to ISPs, a couple of recent overseas decisions demonstrate that ISPs have considerable protection abroad. These decisions may prove useful when interpreting New Zealand's copyright and trade mark law as it applies to ISP liability.

In *Viacom International Inc v Youtube Inc*, the US District Court held that Google was not liable for direct or secondary copyright infringement by hosting infringing content on its YouTube website that is posted by users. The judge held that despite records showing that YouTube was well aware that many of the videos posted infringed copyright, "mere knowledge of the prevalence of (copyright violations) in general is not enough" to establish liability. Google's policy of taking down infringing material once notified of it entitled it to the protection of the safe harbours for ISPs established by the Digital Millennium Copyright Act. The decision has been appealed. The outcome will be important for New Zealand ISPs as it will indicate how the similar safe harbour provisions of New Zealand's Copyright Act are likely to be interpreted.

The *Viacom* case follows the decision in March 2010 of the European Court of Justice in the *Google AdWords* case. This case confirmed the passive position of an ISP in relation to trade mark infringement online. The ECJ found that Google's Adword system does not infringe the trade mark rights of a brand owner when that brand owner's marks are used by another party to trigger the sponsored advertisements involved in Google's service. The Court found that Google acted as a passive ISP, and did not use the trademark by creating the technical conditions for its use and receiving payment for it. However, the ECJ decision provides some comfort for trademark owners, with the Court leaving open the possibility that brand owners could prevent use of their trade marks in AdWords where that use resulted in confusion about an economic link between a third party and the owner of the trade mark.

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## Feltex directors found not guilty

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In a recent District Court case, the 5 former directors of Feltex Carpets Limited (Feltex) have been found not guilty of the charges brought against them by the Ministry of Economic Development in relation to Feltex's 31 December 2005 interim financial statements.

It was alleged that the financial statements did not comply with the applicable reporting standards (NZIFRS), as a breach of bank covenants was not disclosed and liabilities to ANZ were not correctly classified as current liabilities, which resulted in a breach of section 36A of the Financial Reporting Act 1993 (FRA).

Although the directors accepted that the financial statements did not comply with the applicable reporting standards and therefore a breach of section 36A was established, the directors successfully relied on section 40 of the FRA by showing that they took all reasonable and proper steps to ensure compliance with the applicable requirements of the FRA.

The directors' successful defence was based on the actions they had taken to prepare for the change from GAAP to NZIFRS, one of which was to instruct Ernest & Young, a highly reputable accounting firm, to prepare Feltex's first set of financial statements required to comply with NZIFRS. Although the prosecution tried to suggest that "all reasonable and proper steps" included the directors looking at the accounting standards themselves, the judge found this to be "utterly unrealistic" and agreed that section 138 of the Companies Act 1993 (CA), which allows directors to rely on expert advice they receive so long as they are acting "reasonably", could be invoked.

The main point to take from this case is that as long as directors act reasonably and in good faith, they may rely on expert advice in satisfying the defence under section 40 of the FRA. However, the additional and more intriguing point to take from this case is the suggestion that if the judge was willing to apply section 138 of the CA to an offence under the FRA in this case, there is the possibility that section 138 could be extended to similar director defences in other pieces of legislation in the future.

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