BUDDLE FINDLAY

Legal update on banking and commercial - April 2013

16 April 2013

Banking

Dangers of delaying sale of mortgaged property

The recent Supreme Court of New South Wales case of *Commonwealth Bank of Australia v Thompson* illustrates the dangers of a mortgagee in possession delaying the sale of mortgaged property. In this case the delay led to the mortgagee abandoning its claim against the guarantor for interest accrued during the period of its inactivity.

The bank took possession of the property by appointing a receiver under its mortgage, and put the property on the market for sale. However, after that the bank did not take any active steps to market or maintain the property for over 18 months. When the bank initiated proceedings against the guarantor to recover over A$3 million, inclusive of interest accrued to the date of the hearing, the guarantor argued that the bank's inaction after entering into possession caused prejudice to the guarantor because the guarantor could not cause the mortgagor to sell or maintain the property, and therefore was unconscionable.

The bank, possibly after seeing the Court leaning towards granting relief to the guarantor, made a concession on the last day of hearing, reducing its claim to A$1.9 million with interest to accrue only from the date of judgment, effectively dropping its claim for interest over the 18 month period of inaction. The Court held that the prejudice suffered by the guarantor had been ameliorated by the bank's concession and, therefore, the conduct of the bank was not unconscionable. Judgment was given for A$1.9 million plus interest from the date of judgment.

This case serves as a warning that if a mortgagee in possession takes initial steps to sell a property, but then fails to take active steps to market or maintain it, it may find itself unable to recover interest from a guarantor during the period of its inactivity. However, it would be unusual in New Zealand, as a matter of practice, for mortgagees to enter into possession (given the obligations that entering into possession trigger) and there is well established case law in New Zealand to the effect that the mortgagee has the right to decide when it is appropriate to sell the property, and to make that decision in its own interest (see *Mitchell v Trustees Executors Ltd* [2011] NZCA 519).

Financial Service Providers regime - changes announced

Proposed changes recently announced by Cabinet look to strengthen existing regulatory powers granted under the Financial Service Providers (Registration and Dispute Resolution) Act 2008 (the Act). The changes aim to prevent any further misuse of the register by overseas entities, therefore helping to maintain New Zealand's reputation as a trusted jurisdiction to do business in.

The changes are in summary:

- Allowing the Financial Market Authority (the FMA) to direct the Registrar of Financial Service Providers (the Registrar) to decline a registration or to de-register a provider where the FMA is not satisfied that the registration meets the purposes of the Act
- Extending the Registrar’s powers of inspection to seek any information necessary to determine whether a financial service provider should be registered, including whether an application should be referred to the FMA
- Disqualifying persons with overseas criminal convictions for theft, fraud or money laundering within the past five years from registration (persons convicted within New Zealand are already disqualified).

When is a bank's conduct considered "oppressive"?

The central issue in the recent Court of Appeal decision of *Colley v Westpac New Zealand Limited* [2013] NZCA 57 was whether the Bank's conduct was "oppressive" within the meaning of section 118 of the Credit Contracts and Consumer Finance Act 2003 (the Act). Section 118 provides that, in the Act, ""oppressive" means oppressive, harsh, unjustly burdensome, unconscionable, or in breach of reasonable standards of commercial practice". Traditionally this has been viewed as a high threshold.

This case concerned two appeals arising out of the collapse of Next Electronic Servicing Ltd. Mr and Mrs Colley were guarantors of that company's indebtedness to the Bank. The Bank sought summary judgment against the Colleys as guarantors for the shortfall owing by Next. In the first instance, summary judgment was given against Mr Colley but was declined against Mrs Colley. Mr Colley appealed against the entry of summary judgment against him, and the Bank against the refusal to enter summary judgment against Mrs Colley.

Mr Colley's claim of oppression was based on the following essential points:

- The Bank failed to disclose reservations about Next
- Commissioning a report from BDO (who were Next's accountants) lacked independence
- The Bank misled Mr Colley as to the reasons and circumstances surrounding the transfer of the account to the Credit Restructuring Unit
- There were failure and delays on the Bank's part in reviewing Next's position and Mr Colley's wishes for a meeting
- Obtaining a report from McGrath Nicol was oppressive
- Cancelling the overdraft facility and appointing receivers were oppressive.

The Court dismissed each of these factors noting the following:

- It is not oppressive for bank managers to not fully disclose to a customer all their opinions about its financial position.
- It made sense for the Bank to get a report from BDO as the firm which was already familiar with the dealings with Next. The later decision (to get another report from accountants entirely independent of the Colleys) was made as a consequence of the problematic situation that the BDO report revealed. The Court expressed the view that, even if using BDO was unwise, the decision could not in any circumstances be described as harsh or unjustly burdensome, or in breach of reasonable standards of commercial practice and therefore oppressive.
- It was up to the Bank how it managed the account (ie, transferring the account to another unit of the Bank), and it was not unjust or in breach of reasonable standards of commercial practice if it did not disclose all its considerations to its customers. In any case, the statements given by the Bank were frank and accurate.
- The real complaint behind the alleged failures and delays was that the Bank did not keep extending the overdraft facility as Mr Colley wanted. To that effect, the Court provided that the Bank had no obligation to provide further funding.
- The McGrath Nicol report was not considered oppressive for the above mentioned reasons.
- There was nothing oppressive in the conduct of the Bank in cancelling the overdraft facility or in the way in which receivers were appointed. Mr Colley had contemplated a collapse of the company some three months earlier, he had received notices of default and had been informed of the transfer of the account to the Credit Restructuring Unit.

Mrs Colley's claim of oppression was based on the following factors and she argued that singly or in combination these factors made it oppressive for the Bank to demand the full amount under the guarantee:

- She was a reluctant guarantor
- She felt pressured and rushed at the time of signing when her lawyer explained that she was signing a personal guarantee
- She thought that their home was the only asset in which she had a interest that was at risk under the personal guarantee
- She was not aware of the increased facility limit of the overdraft facility.

The Court of Appeal dismissed these factors and clearly expressed the position under the Act that the oppression provisions of the Act are not focused on personal hardship to a debtor. Rather, the focus is on the acts of the creditor, either in relation to the contract or transaction itself, or the creditor's specific acts before or after the credit contract arose. A credit contract cannot be impugned as oppressive by reference to matters that affected the debtor but which were unknown to the lender.

The guarantee stated in plain words that Mrs Colley was guaranteeing all existing and future indebtedness of the company and that the Bank was entitled to enter into new, or change existing, arrangements at any time without Mrs Colley's consent. The documents squarely informed that there could be future increases.

In addition, the Bank was provided a guarantor's solicitor's certificate recording that the solicitor had explained to Mrs Colley the general nature and effect of the guarantee. The Bank was also provided with an acknowledgement signed by Mrs Colley stating that she had been advised to obtain independent legal advice, and that she understood the terms and provisions of the documents including certain specific matters.

The Court held that the Bank acted with reasonable standards of commercial practice by relying on the solicitor's certificate and waiver of independent legal advice and there was no basis to conclude that the Bank had acted oppressively in increasing the loans without notifying Mrs Colley, in making demand on her, or in claiming from her the full amounts advanced.

We agree with the Court of Appeal's approach and reasoning and we would be concerned if the Courts were to find any of the above factors oppressive given the factual circumstances and the clear contractual terms. However, the case illustrates the importance of clear terms and provisions and the advisability of Banks obtaining solicitor's certificates and, where relevant, waivers of independent legal advice from guarantors.

Swap clearing under Dodd-Frank

Mandatory clearing of swaps for certain swap participants under The Dodd-Frank Wall Street Reform and Consumer Protection Act (US) (Dodd-Frank) has come into effect.

As part of the continuing implementation of the key goals of Dodd-Frank, swap dealers, major swap participants and active funds are required to clear certain swaps through registered or exempt derivatives clearing organisations.

Dodd-Frank was enacted into US law in July 2010 and is seen as the most comprehensive reform of US financial services regulatory law since 1933, covering broad aspects such as the oversight and supervision of financial institutions and the regulation of over-the-counter (OTC) derivatives.

In relation to the regulation of OTC derivatives, Dodd-Frank introduces requirements for the registration of market participants who are swap dealers or major swap participants, clearing, execution and reporting of swap transactions, and margin posting in respect of non-cleared swaps.

Certain aspects of Dodd-Frank are intended to have extra-territorial application. The Commodities Futures Trading Commission (CFTC), being the body charged with the regulation of swaps in the US, has issued a cross-border proposal that would impose the registration requirements and certain entity level and transactional requirements under Dodd-Frank on non-US market participants that engage in swap transactions with US counterparties. However, until the proposal is finalised, the CFTC has issued a time-limited exemptive relief to cross border market participants from the requirement to comply with some of these rules.

The clearing requirement is being phased in during 2013, with swap dealers, major swap participants and active funds required to clear certain classes of index credit default swaps and interest rate swaps entered into on or after 11 March 2013. The clearing requirement also applies to changes in the ownership of a swap. Pursuant to the CFTC's time-limited relief, the clearing requirement currently only applies to swap transactions entered into with US counterparties.

There are also certain exemptions to the mandatory clearing requirement, such as the "end-user" exemption for non-financial entities hedging commercial risk. We expect that most market participants caught by the Dodd-Frank clearing requirement will continue to clear swap transactions via intermediaries that are already members of a registered clearing house.

To fulfil its G20 commitment, the EU has also adopted regulation (the *European Market Infrastructure Regulation on OTC Derivatives, CCPs and Trade Repositories*)aimed at regulating OTC derivatives. While the EU regulation is intended to apply principally to swap transactions between EU counterparties, clearing and risk mitigation obligations under the EU regulation can extend to transactions with non-EU counterparties in certain circumstances. It is expected that the first clearing obligations under the EU regulation will commence in May 2014.

Commercial

Further extension on Real Property Developments Exemption

Of relevance to those involved in property developments, the Securities Act (Real Property Developments) Exemption Notice 2007 (the Property Exemption) has been extended until 30 September 2013 while the more substantive changes are considered.

In justifying this extension, the Financial Markets Authority (FMA) affirmed that securities offered as ancillary features to real estate transactions which are not conventional investments should not be subject to the ordinary disclosure requirements of the Securities Act 1978 (the Act) and the Securities Regulations 2009 – most notably, the requirements to provide a prospectus and appoint a statutory supervisor.

Over the next six months, the FMA will consider substantive changes to the Property Exemption. Currently, the Property Exemption excludes the need to comply with particular sections in Part 2 of the Act, provided that a series of conditions are met. In a recent report, the FMA announced that it may broaden the Property Exemption to provide a complete exemption from Part 2 of the Act and that it may simplify the conditions imposed. These proposed changes would make compliance more straight forward and will no doubt be welcomed by those relying on the Property Exemption.

The FMA will be consulting on these proposed reforms and are aiming to release a consultation paper soon. The amended Property Exemption is available on the FMA's website.

Commerce Commission seeking comments on M&A and Authorisation Guidelines - consultation drafts released

The Commerce Commission (the Commission) has been receiving comments on the new draft Mergers and Acquisitions Guidelines and Authorisation Guidelines. These guidelines set out how the Commission will assess mergers and acquisitions, clearance applications and authorisation applications.

The Commerce Act 1986 prohibits mergers that are likely to substantially lessen competition in a market. Merging firms may, however, apply to the Commission for clearance or authorisation of a proposed merger. The draft Mergers and Acquisitions Guidelines essentially set out how the Commission will assess whether a merger is likely to substantially lessen competition and the process to be followed for clearance applications. The current guidelines were published in 2003 and the latest draft includes updates to reflect recent decisions by the New Zealand Courts and the Commission, international best practice based on merger guidelines in specified jurisdictions and the Commission's plain English standard. They will ultimately also include the Commission's Failing Firms and Divestment Remedies Guidelines – the intention being to provide a "one stop shop" setting out how the Commission assesses clearance applications.

The draft Authorisation Guidelines explain the Commission's process when determining authorisation applications. Anti-competitive transactions (such as mergers or arrangements that are likely to substantially lessen competition) may be authorised if the public benefits arising from the transaction outweigh the competitive detriment. The draft Authorisation Guidelines incorporate an updated version of the Benefits and Detriments Guidelines, first published in 1997.

Final sets of both guidelines are expected to be published by mid-2013. Until that time, the 2003 Mergers and Acquisitions Guidelines and 1997 Benefits and Detriments Guidelines will remain relevant.

The Commission is receiving comments on the draft guidelines and is holding a series of briefings for legal advisers and economic agencies, which Buddle Findlay is participating in.

Less than three months until AML/CFT Act goes live. Are you ready?

With the implementation date of the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 (the AML/CFT Act) less than three months away, many reporting entities are fine-tuning their AML compliance programmes in anticipation of 'going live' on 30 June 2013.

In response to feedback from reporting entities and other stakeholders, the Ministry of Justice, in consultation with the three AML/CFT Act supervisors (the Financial Markets Authority, the Department of Internal Affairs and the Reserve Bank of New Zealand) recently announced the contents of a set of regulations to be passed into law prior to 30 June 2013. These regulations will address a number of technical issues that reporting entities have encountered while devising their AML/CFT compliance programmes. The regulations will, among other things, prescribe the form of annual reports and suspicious transaction reports and require reporting entities to conduct 'enhanced' customer due diligence where there is a suspicion of money laundering (even when the transaction in question falls below the prescribed threshold which would otherwise need to be satisfied for enhanced customer due diligence to apply).

The regulations will also amend the rules regarding an AML/CFT compliance officer across a designated business group (DBG). Currently, the AML/CFT Act requires all members of a DBG to each appoint their own AML/CFT compliance officer. This requirement arguably undermines the purpose of the DBG provisions, which are intended to simplify compliance for financial institutions whose businesses consist of multiple reporting entities within the same corporate group. In reality, each member of a DBG would likely appoint the same person to be its compliance officer, who would likely replicate the same compliance functions across each reporting entity. The regulations will enable one individual to be appointed as the AML/CFT compliance officer for an entire DBG. This is a welcome move that better aligns the mechanics of the legislation with the stated purpose of reducing the compliance burden of the AML/CFT Act in appropriate circumstances.

As the implementation date approaches, we are seeing an increased focus by reporting entities on translating the general principles of their AML/CFT programme into their business procedures. Please contact our financial services team or your usual Buddle Findlay adviser for assistance with any aspect of your AML/CFT programme.

Auckland

188 Quay Street
Auckland 1010

PO Box 1433
Auckland 1140
New Zealand

P: +64 9 358 2555
F: +64 9 358 2055

Wellington

Aon Centre
1 Willis Street
Wellington 6011

PO Box 2694
Wellington 6140
New Zealand

P: +64 4 499 4242
F: +64 4 499 4141

Christchurch

83 Victoria Street
Christchurch 8013

PO Box 322
Christchurch 8140
New Zealand

P: +64 3 379 1747
F: +64 3 379 5659