Legal update on technology, media and communications - December 2015

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10 December 2015

New penalties decision

The rule against penalties is an issue that comes up in the ICT contracting space reasonably frequently. Essentially the rule means that a court may refuse to enforce a provision requiring one party to pay another party money in event of a contractual breach if that amount is a penalty. The test of whether a payment is a penalty has traditionally been whether or not it is a 'genuine pre-estimate of loss'.

Most often, the rule comes up in discussions about liquidated damages provisions where a party agrees to pay a certain amount for failure to meet a key contractual milestone. However, it is also relevant to other payments made in ICT contracts such as service credit regimes and early termination payment provisions.

Part of the uncertainty about the application of the rule has arisen due to Australian case law in the last few years regarding the enforceability of bank fees. Traditionally an amount could only be an unenforceable penalty if it was triggered by a breach of a contractual obligation. However, in the key case of *Andrews v ANZ* [2012] HCA 30; 247 CLR 205 the High Court held that it is not necessary for a fee to be payable for a breach of contract for the rule against penalties to be engaged. This potentially widened the scope of the rule to affect a number of common contractual mechanisms which require payments (or remove a right to receive a payment) but aren't triggered by a breach of contract such as 'take or pay' contracts or contracts where rights to terminate a contract carry with them a loss of accrued rights (eg loss of a trailing commission) or require payment of an early termination fee.

The uncertainty also arose because there was some debate about what was a genuine pre-estimate of loss and whether this was indeed the only test.

The recent United Kingdom Supreme Court decision, *Cavendish Square Holdings BV v Makdessi* [2015] UKSC 67*,* addresses the uncertainty and suggests that the threshold under English law for finding that a clause creates an unenforceable penalty is a high one.

While the Supreme Court did not abolish the penalty doctrine it did restate it. In doing so it:

- Considered and rejected the Australian approach in the *Andrews* decision and held that under English law the doctrine still requires that the alleged penalty is triggered by a breach of a contractual obligation
- Held that the distinctions drawn between a penalty and a genuine pre-estimate of loss are unsatisfactory and artificial. The true test was whether the clause *"imposes a detriment on the contract-breaker out of all proportion to any legitimate interest of the innocent party in the enforcement of the primary obligation."*

The Supreme Court noted that the penalty doctrine may undermine the certainty which parties are entitled to expect of the law and that if the relevant contract is negotiated by properly advised parties with comparable bargaining power, there is a strong initial presumption that the parties are the best judges of "*what is legitimate in a provision dealing with the consequences of a breach*". While we do not yet know whether New Zealand law will follow either the Australian or the English approach to the doctrine, the UK Supreme Court decision is, in our view, a welcome development which puts the focus back on freedom of contract.

Annual report of the Privacy Commissioner

The annual report of the Privacy Commissioner was recently released. It covers the year ending 30 June 2015, which is Commissioner John Edwards' first full year in office. The report lists a number of highlights, including a focus on making privacy easy for private sector organisations, public sector agencies, and individuals, and the growing value of privacy in society – emphasised by significant damages awarded by the Human Rights Review Tribunal in two separate cases over the year.

In addition to the direct financial consequences, the report emphasises the increased accountability for agencies that get things wrong: the Office of the Privacy Commissioner has adopted a 'naming policy' for publicly naming organisations that do not comply with their privacy obligations.

Large-scale data breaches often involve IT systems and so privacy issues tend to be high on the agenda in the ICT industry. The possible consequences of breaches (including the Privacy Commissioner's naming policy) are important to keep in mind given that the Office has experienced a trend of increasing numbers of media and public enquiries, and complaints over the past five years. This trend can be expected to continue as the Privacy Commissioner continues guidance, education, and awareness initiatives

The full report is available here.

TPPA and IP – FYI

With the Trans-Pacific Partnership Agreement (TPPA) text finally being released, we now have a little more visibility as to how New Zealand's intellectual property laws may change.

Patent term extensions, grace periods and protection for software 'as such'

Patent term extensions will be required, presumably up to 5 years from the expiry date of the 20 year term. These extensions are designed to compensate for unreasonable delays in the patent examination process and unreasonable delays in the safety and efficacy approval process run by Medsafe. In theory, extension of term will be available for all inventions, including those in the ICT field. However in practice, they are most likely to be granted to pharmaceutical inventions rather than ICT inventions. Interestingly, patent extensions, which were available under the Patents Act 1953, were excluded from the new Patents Act 2013 as the costs were said to outweigh the benefits. MFAT's present position is that an extension of term regime will have little impact on New Zealand.

A grace period of 12 months for prior public disclosure by the inventor will be required. That is, any disclosures about the invention by the inventor in the 12 months before a patent application is filed will be disregarded for the purposes of judging the novelty and inventiveness of the alleged invention. This is a substantial change for New Zealand. Although a number of our trading partners currently allow grace periods, New Zealand has not done so in the past. Grace periods are likely to be welcomed by all inventors as, compared to the current law, they will allow inventors to obtain a patent if there has been inadvertent disclosure during the grace period, and also allow commercial testing of an invention during the period, without destroying the validity of a subsequent application.

The patentability rules relating to software are unaffected by the TPPA. That is, computer programs 'as such' remain excluded from patentable subject matter and it remains to be seen how the rules will be interpreted in New Zealand.

Longer copyright term

Another key TPPA change is the extension of the term of copyright protection in many works from the life of the author *plus 50 years* to life *plus 70 years*. The expected cost of this extension to New Zealand consumers is $55 million a year and some commentators have questioned whether there will be an overall benefit or cost to New Zealand consumers and copyright owners. Australia already has a general copyright term of the author's life plus 70 years.

Technological Prevention Methods

New Zealand already has laws restricting the circumvention of Technological Prevention Measures (TPMs). The TPPA requires stronger TPM's to be implemented, but preserves exceptions already provided under New Zealand law.

Under the coming into force provisions of the TPPA, New Zealand will have two years from the date of signing of the agreement to complete *"domestic approval, legislative and ratification procedures".*

The full text of the TPPA can be read on MFAT's website.

The taxation of online purchases

Following a government discussion paper, legislation has been introduced to extending GST to online purchases of services and intangibles by New Zealand consumers from overseas suppliers.

Currently, services and intangibles purchased online from overseas are not subject to GST. This puts New Zealand based suppliers of similar services at an arguable disadvantage and, from the government's perspective, leaves tax revenue 'on the table'. Under the draft bill, which reflects OECD recommendations, purchasing services or intangibles (eg ebooks, digital music) online from overseas suppliers will cost extra for the consumer to the tune of New Zealand's normal GST rate, 15%.

To facilitate this recovery of GST, overseas suppliers will need to register with the IRD and return GST at the rate of 15% on supplies made to New Zealand consumers (supplies made to New Zealand GST registered businesses will be treated as either outside the scope of New Zealand GST altogether, or subject to New Zealand GST at the rate of 0% if the supplier and recipient agree). Quite how this will work with the likes of Trade Me's overseas based sellers, or large-scale overseas online retailers like Amazon remains to be seen. You can imagine overseas suppliers will resist additional compliance formalities and costs just to serve New Zealand's tiny market. This might lead to overseas suppliers excluding New Zealand consumers from their sales or only selling through some sort of consolidated marketplace. In some cases the registration for GST may be done through a consolidated marketplace (such as eBay) as non-resident operators of electronic marketplaces will be treated as the supplier of remote services (and therefore the person liable to register for and return New Zealand GST) unless all of the following apply:

- The electronic marketplace does not authorise the charge to the recipient, or the delivery of the supply or set the terms and conditions under which the supply is made
- The documentation provided to the recipient identifies the supply as being made by the underlying supplier and not the electronic marketplace
- The underlying supplier and the operator of the marketplace have agreed in writing that the supplier is liable for New Zealand GST.

These changes to overseas supplied services and intangibles will apply from 1 October 2016.

The government's discussion paper also included some discussion on the possible imposition of GST to low value goods supplied from overseas. At this stage however, the draft bill does not include any clauses that would change the current GST treatment of low value goods supplied from overseas.

Currently if the duty/GST is less than $60 it is not required to be returned/applied (the 'de minimis' rule). Again, tax revenue may be being left on the table and the current position arguably discriminates against local suppliers of substitutable goods.

The discussion paper can be found here and the draft bill can be found here.

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