

Financial Law Update

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Banking and finance

Australian Personal Property Securities Bill update

The Australian Senate Legal & Constitutional Affairs Committee has tabled its report in the Senate on the Exposure Draft of the Australian Personal Property Securities Bill. The Committee recommended, among other things, that the commencement of the scheme contemplated by the Bill be delayed by at least 12 months to May 2011.

The Personal Property Securities Bill 2008 is largely Australia's equivalent to the New Zealand Personal Property Securities Act 1999. The Australian Bill seeks to reform the law relating to:

- the creation of valid security interests in personal property
- the priority of competing security interests in personal property
- acquiring personal property free of security interests
- enforcing security agreements upon default by a debtor.

It is proposed that Australia will have a 'PPS Register' so that security interests can be searched on a centralised online database.

Once introduced, the Australian personal property securities legislation will streamline the taking of security in Australia. It is proposed that the Bill is to replace over 70 pieces of Commonwealth, State, and Territory legislation. Not only will lenders and suppliers benefit from one set of rules for all States; it will also provide a familiar platform for banks and other lenders that are operating in New Zealand as well as Australia.

Want to know more?

If you would like further information in relation to the proposal please contact [Nick Lodder](#) on (09) 375 1194 or contact the team at financiallawupdate@kensingtonswan.com.

Emission Trading Scheme: amendments to the Personal Property Securities Act

The Climate Change Response (Emission Trading) Amendment Act 2008 has amended the Personal Properties Securities Act 1999.

The definition of 'investment security' in section 16(1) of the PPSA is amended by including an 'emissions unit'. As a result an emissions unit now constitutes personal property and is subject to the PPSA.

Suppliers can now register their security interest in emissions units on the PPSR and take advantage of the protection given by the PPSA.

It is worth noting that the PPSA has been amended to include special rules for taking possession of emissions units. This is relevant to a secured party's priority, as possession of an emissions unit will, in some cases, have priority over registration of a security interest on the PPSR.

As a result of the amendment a person can take possession of an emissions unit if the emissions unit is, in the ordinary course of business:

- traded or settled through a clearing house or securities depository, and the clearing house or securities depository records the interest of the person in the emissions unit
- not traded or settled through a clearing house or securities depository, if the unit register records the name of the person as the possessor of the unit; or
- held by a nominee, if the records of the nominee record the interest of the person in the emissions unit.

The amendments to the PPSA now give emissions units the same security status as other readily traded assets. Whether emissions units are widely traded and used as security has yet to be seen.

Want to know more?

If you would like further information in relation to the amendments, and how they might impact on your business, please contact [Nick Lodder](mailto:Nick.Lodder@kensingtonswan.com) on (09) 375 1194 or contact the team at financiallawupdate@kensingtonswan.com.

Securities Commission bans advertising for moratorium restructure

In April 2009 the Securities Commission announced that it banned advertisements by Propertyfinance Securities Limited for a proposed restructure of its moratorium arrangements.

PFSL is a finance company that has been in a moratorium since December 2007. Before then it had been in receivership since August 2007. Since failing to meet a scheduled payment in December 2008, PFSL has been developing a proposal to restructure its moratorium.

PFSL advertised its proposed restructure in roadshow presentations to investors and in briefing notes published on its website.

The Commission stated that PFSL's proposal sought to vary the terms of the existing

securities held by debenture holders, and therefore amounted to a new offer of securities under New Zealand securities law. The Commission was of the view that the offer did not comply with the law because no registered prospectus was available.

In the Commission's opinion, the PFSL's roadshow presentations and website material were also likely to mislead investors because they only set out the positive aspects of the

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proposal and the negative aspects of the receivership option. This was not seen as providing balanced information upon which investors could make informed decisions.

The Commission has advised that PFSL directors had received legal advice on their presentation and believed the contents to be true and accurate, however they respect the Commission's views and findings.

Recent court decisions

As always, the Courts have been kept busy by banking and finance matters. We outline below two recent decisions that are likely to be interest.

Credit Contracts and Consumer Finance Act 2003: reasonable prepayment fees

The Commerce Commission has been proactive in reviewing compliance by credit providers with the Credit Contracts and Consumer Finance Act 2003 and, in particular, the break fees charged by credit providers. In addition to issuing guidelines outlining its view on how the Act should be interpreted, it has taken action against credit providers who it considers have not complied with the Act.

Under the Act, in the event that a consumer credit contract is fully prepaid, the credit provider is entitled to charge 'a reasonable estimate of the creditor's loss arising from the full prepayment.' To assist in determining what a 'reasonable estimate' is, the regulations outline a 'safe-harbour' formula which a creditor can adopt. If the creditor adopts the prescribed formula, any amount recovered is deemed to be reasonable. However, a creditor

is not obligated to use the safe-harbour provision and may adopt its own formula for determining its reasonable loss.

The decision in *Commerce Commission v Avanti Finance* is the most recent handed down by the Courts considering the reasonableness of prepayment fees. As you may recall, the District Court had earlier found that the formula adopted by Avanti resulted in it recovering a reasonable loss and, therefore, not acting in breach of the Act. The Commission appealed that decision to the High Court.

The formula adopted by Avanti was based upon an assessment of the loss it would suffer on the unearned interest on the loan. Notwithstanding that Avanti's experience was that loans were prepaid, on average, 15.7 months early, Avanti elected to cap the interest period for calculating the prepayment fee at 90 days at the contracted interest rate.

The Commission argued that Avanti's formula was inappropriate, and that creditors were required to calculate their loss on the assumption that if the funds were prepaid, they would be re-lent at the prevailing interest rate. The reasonable loss suffered, therefore, was the difference between the original interest rate charged on the loan prepaid and the rate at which the funds could be lent at the then prevailing interest rates, as applied in the safe-harbour formula. In effect, the Commission argued that if a creditor elected to adopt its own formula, that formula could not be inconsistent with that prescribed by the regulations.

While noting that the purpose of the Act was consumer protection, the Court held that this purpose did not mean that a creditor should accept a loss on prepayment. Rather, the issue is whether what the creditor seeks to recover is 'reasonable' based upon an objective analysis at the time the credit contract was entered into. A fee would be 'reasonable' if it did no more than compensate the creditor for the actual losses it could expect to sustain in the event of prepayment but unreasonable if it enabled the creditor to recover 'significantly' more than the actual loss arising from prepayment.

In the present circumstances, the Court found Avanti had not breached the Act because its excess lending capacity meant that it was not dependent upon the outstanding loans being repaid before new loans could be made. It was, therefore, incorrect that reasonableness would always be linked to the ability to re-lend the particular funds. The loss suffered by Avanti was, therefore, not the difference between the interest rate charged on the initial loan and the interest rate at which the funds *could* be lent at, but the profit on the interest Avanti charged had the loan gone to maturity. The Court concluding that it 'is perfectly reasonable for a loss to take into account the fact that a new loan will not replace the old, and that the profit on a loan is lost through prepayment.'

The Court also rejected a submission that an adopted formula had to be consistent with the safe-harbour formula and noted that the two possibilities for determining loss were 'true alternatives'. It concluded that 'it makes no logical sense for the legislature to have provided two alternative methods for calculation of a reasonable estimate of loss, but have one essentially driven by the terms of the other.'

The decision of the Court does not, however, give creditors complete discretion to determine their 'reasonable losses'. Central to the Court's decision was not only Avanti's excess lending capacity, but that:

- the formula was not arbitrary but based upon Avanti's past experience
- legal guidance had been sought in fixing the formula
- the interest period for calculating the prepayment fee was capped
- the formula was applied notwithstanding changing conditions, which meant that Avanti recovered less than it would have had it applied the safe-harbour formula.

In the present climate, with the Commerce Commission likely to remain conscious of the amounts charged by credit providers, it is an opportune time for credit providers to review their prepayment formulas to take account of the Court's observations in *Avanti*.

Mortgagee's application to purchase mortgaged property

The Property Law Act 2007 permits a mortgagee who is entitled to sell the mortgaged property to apply to the Court for permission to purchase the mortgaged property in question.

In *Canterbury Building Society*, the mortgagee was entitled to sell the mortgaged property and applied to the High Court in Christchurch for an order permitting it to purchase the property.

The Court stated that information about the price at which the applicant wished to purchase the property was essential in an application of this kind.

The applicant was the registered mortgagee of three units in Kaikoura. The mortgagor defaulted in 2008 and, after serving a section 119 notice, the mortgagee decided to exercise its powers of sale in September 2008.

The mortgagee obtained a valuation of the properties from a registered valuer in September 2008. From September 2008, the properties were marketed extensively.

Several conditional agreements failed to settle and the mortgagee rejected a number of offers which it believed did not reflect market value.

The mortgagee then decided that it would purchase the property itself. The application was served on the mortgagor, guarantor, and subsequent mortgagee as required by the Act.

The Court noted that, in this instance, there was no prejudice to any subsequent mortgagees because that there was no possibility of the building society recovering the full amount secured by its mortgages.

The Court noted that the ability for a mortgagee to purchase a mortgaged property was introduced by the 2007 Act and that the legislation does not set out any criteria for the Court to look upon for guidance. However, the Court was of the view that the application must be considered in the context of the mortgagee's obligations when conducting a mortgagee sale: namely the duty to exercise the power of sale in good faith, and to obtain the best price reasonably obtainable.

Thus, before granting an order of this nature, the Court held that a mortgagee should look to its obligations under the Act in relation to the conduct of a mortgagee sale for guidance when applying to purchase a mortgaged property.

Want to know more?

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Start a conversation with us...

Your team of specialists at Kensington Swan are on top of the issues and can provide you practical advice on operating in today's dynamic business environment.

If you would like further information call your usual Kensington Swan adviser or contact the team at financiallawupdate@kensingtonswan.com.

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