

## CORPORATE MERGERS AND ACQUISITIONS >>UPDATE

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### Top tips for 2010

With the year almost over, it's time to look ahead to 2010. The new year could see some significant changes in the business regulatory environment, bringing potential opportunities for businesses while introducing higher compliance costs for others. The start of a new year is also a good time to ensure your business is in the best position possible. To help you have a happy new year, we outline legislative changes to look out for and offer you our Top Tips for 2010.

#### Overseas Investment Regime

During 2009 the Government embarked on a review of the overseas investment regime. The resultant changes will impact on businesses in 2010. One of the most important changes is the increased delegated authority to the Overseas Investment Office. The Office now has broader scope to determine applications, at the expense of requiring ministerial consent. The Government still retains overall authority for applications dealing with sensitive land. In a more controversial move, application fees rocketed, substantially increasing compliance costs to potential investors.

Further changes are in the pipeline. Although these changes are intended to decrease barriers to entry, their actual impact remains uncertain. Watch this space during 2010 to see how these changes will affect you.

### Capital Markets Taskforce

The Capital Market Development Taskforce ('Taskforce') was set up in July 2008 to review the state of our capital markets, the international context, future risks, opportunities, and crucial changes necessary to provide the best possible financial system for New Zealand. In July 2009 the Taskforce released its second interim report focusing on issues relating to New Zealand's financial markets generally, as well as financial advisers and securities disclosure. A number of reforms were suggested in this report.

At the end of 2009 the Taskforce will release its final report. It is likely to recommend regulatory changes to improve investor outcomes in financial products and advisory markets, tax changes, improved regulation to reduce costs and uncertainty for issuers, and changes to the role of government in capital markets. The Taskforce is an industry-led team charged with the mission of producing a blueprint and action plan to develop New Zealand's capital markets.

In 2010 the government is likely to consider implementation of the recommendations received, which could lead to substantial changes in these areas.

### Financial Reporting Revisited

The Ministry of Economic Development has released a discussion paper which proposes changes to financial reporting obligations. The closing date for submissions is 29 January 2010. In particular the Ministry is calling for submissions on which entities should have financial reporting obligations. The paper proposes to remove the requirement to prepare financial statements for 98% of companies.

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However, large, privately owned New Zealand companies will be required to file general purpose financial reports. What encompasses a large company is likely to be expanded. This could potentially require some companies that do not have to currently file any financial statements to comply with financial reporting requirements. See our article in this issue of the M & A Newsletter for further information on the proposed changes and how to have your say.

### Using the Personal Property and Securities Register

In this tough economic climate, registering security interests in the Personal Properties Security Register ('PPSR') is increasingly important. With economic conditions not expected to improve dramatically, this should be a continued area of focus for all those clients supplying goods or services under a retention of title. Registering your security interests places you in a better position against bad debtors and competing creditors with unregistered security interests. A failure to register security interests may mean that another creditor with a similar interest is preferred when payments are made or assets distributed from an insolvent debtor.

Use the PPSR and protect yourself and your business!

### **NZX Clearing House**

The NZX is implementing a Clearing House and Settlement System in order to promote confidence and participation in NZX's markets. The system is intended to bolster the risk profile of NZX Markets and broaden the product set available to investors. In a centralised system all trades run through one clearing house, in this case operated by NZX, which takes on the counterparty risk. The

clearing house acts as a central counterparty to net, clear and settle trades. It replaces the old system that required participants to take counterparty risk against each other and settle trades bilaterally.

The introduction of a clearing house will bring NZ into line with international norms. It will also allow the stock exchange to expand into other markets such as derivatives. The NZX stated that equity options, index futures, and dairy commodity derivatives products would be launched in a phased approach over the next twelve months.

### **M & A forecast for 2010**

2009 has been another challenging year for mergers and acquisitions. Vendors, realising they would not get the prices they wanted, have focussed on continuing to create value in their businesses, and purchasers have often found availability of funding difficult.

The outlook for 2010 is more encouraging. We have noticed an increase in the availability of funding and a re-alignment of price expectations between vendor and purchaser. Anecdotally, the market is also seeing an increased participation by private equity again, together with trade buyers looking carefully at quality assets. In addition the 'succession' issues that have been well explored over recent years have simply been postponed and therefore become more urgent.

These factors, plus a perceived increase in economic performance, suggest a likely increase in activity over the New Year. In addition, the market has adapted to be more 'creative' in its deal-making. Cash has not been as big a hurdle as before, with earn-outs, vendor finance, share swaps, and progressive buy-ins becoming more common elements of transactions.

So, whilst 2010 will not see a return to the heady private equity fuelled days of three to four years ago, we remain optimistic of an increased appetite and ability to do deals. Vendors and purchasers should be considering now how best to respond to this change to ensure they are able to take advantage of opportunities that might arise.

For more information on any of the issues outlined in this article contact a Kensington Swan advisor.

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### Changes to financial reporting: have your say

If your organisation has an annual revenue of over \$20 million you will be affected by the proposed changes to the standards outlining financial reporting obligations. The Ministry of Economic Development (MED) has released a discussion paper 'The Statutory Framework for Financial Reporting'. The paper proposes changes to the standards outlining financial reporting obligations and seeks to generate discussion on which entities should have financial reporting obligations. MED's discussion paper is accompanied by a report by the Accounting Standards Review Board. The closing date for submissions in relation to both discussion documents is 29 January 2010.

Of greatest interest to most businesses are the proposed changes to financial reporting requirements. It is anticipated that the proposed amendments will remove reporting requirements for 98% of companies. Under the proposed arrangements, statutory requirements to file general purpose financial reports (GPFR) will only apply to large companies, issuers and companies that do not have a separation between management and ownership. For other entities, shareholders would have greater discretion as to whether GPFR requirements will apply.

The report recommends that the definition of a large company should be extended thereby increasing reporting requirements for these companies. Currently a company is large if it exceeds any two of the following tests: (i) consolidated assets of \$10 million; (ii) consolidated annual revenue of \$20 million; and (iii)

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50 full time equivalent employees in the company and its controlled entities. The report recommends that a company should only be excluded from the definition of large if it is below the threshold for revenue and one, or both of the asset and employee thresholds. Any company with annual revenue over \$20 million would be subject to reporting requirements, regardless of their size in terms of employees and assets. This means that numerous companies, who are not currently subject to reporting requirements, will be required to file GPFR under the proposed regime.

Significant changes to reporting indicators for Maori asset governing entities and non-profit entities are also proposed.

MED is seeking submissions under each of the following categories:

- 1 Institutions and statutory responsibilities.
- 2 Financial reporting principles and indicators.
- 3 Application of indicators to for profit entities.
- 4 Application of indicators to the public sector.
- 5 Application of indicators to private non-profit entities.
- 6 Application of indicators to Maori asset governance entities.

Kensington Swan offers expertise in advising in each of these areas. If you have any questions in relation to MED's review or would like assistance in preparing a submission, contact one of our experts.

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## Is your virtual signing enforceable?

Virtual signing has taken off in the modern business environment—the pace at which transactions take place, the complexity of multi-party deals, and geographic constraints are all contributors to virtual signing's popularity. How do you ensure your virtual signing arrangements are creating effective and enforceable agreements?

Virtual signing utilises electronic media to transmit copies of agreements, allowing parties to execute counterparts of the same agreement with greater efficiency.

Recent case law from the UK has highlighted some of the precautions that need to be taken when using virtual signing—if certain precautions aren't taken, agreements may be ineffectual.

In the *Mercury Tax Group* case, a company ('Mercury') was charged with conducting a tax avoidance scheme. The scheme required clients to execute certain documents. Mercury's regular practice was to send these documents to the clients in draft form, often with essential terms of the agreement such as the name of the counterparty or the price left blank. The clients would execute these draft documents. Mercury would then complete the details and affix the signature page from the draft document. The Court held that the execution of documents in this manner was ineffective for two reasons. First, the Court found that the execution of the documents was of particular importance to Mercury's clients. Secondly, certain documents required execution in a particular way in order to be valid—for example, the Court determined that a deed (in English law) must be executed as a single document comprising both the agreement and the signature pages. The ineffective execution of the documents assisted the Court to reach the conclusion that Mercury was operating a tax avoidance scheme.

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In New Zealand, certain types of agreements must be executed by deed, and the Property Law Act requires that deeds be executed in a particular way. For instance, if an individual is a party to a deed, he or she must sign the deed and his or signature must be witnessed for the execution to be effective.

Mercury's case is a reminder to be diligent when using virtual signing. This doesn't have to limit your ability to execute multiparty agreements in different places and at different times —the key is to ensure that each party signs the final version of the agreement and that each party signs the same version of the agreement. One potential method, recommended by a joint working party in the UK uses the following steps:

- The parties agree on the arrangements for virtual signing including delivery of the documents.
- Final execution copies are sent to each party as PDF or word copies.
- Each signatory prints only the signature page and executes it correctly.
- Each absent party affixes the signature page to the final copy, and all parties send these to a nominated party.
- Once all counterparts have been signed and returned to the nominated party, a final document with all signature pages attached is circulated to all of the parties.

While this is not the only way to conduct a virtual signing, it is a method that provides parties with certainty as to the terms of the final agreement (which may help prevent future disputes) without losing the efficiency virtual signing offers. Contact Kensington Swan to ensure your virtual signing arrangements are creating effective and enforceable agreements.

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## Transparency boosts marketplace confidence

As we seek to move past the difficulties of recent years, confidence is vital. The financial crisis illustrated how dire the consequences can be when there is a lack of confidence in the marketplace. A recent review by the Securities Commission emphasises the role that transparency in financial reporting can play in boosting marketplace confidence. What steps can organisations take to increase transparency and boost confidence?

Transparency is a significant concern for all businesses no matter how big or small they are.

All company directors have a duty to ensure that accurate financial and accounting records are kept. Certain companies may also have additional requirements under the Financial Reporting Act 1993.

Regulatory requirements are not the only reasons that maintaining compliant financial reporting is important. Recent case law from the Court of Appeal demonstrates the importance of full disclosure in relation to financial reports when selling a business. A vendor can decrease the risk of misleading or misrepresenting potential purchasers by disclosing the assumptions used to value assets or make financial projections. Disclosure of underlying assumptions narrows reliance by a purchaser on representations made by the vendor. In turn, this reduces the vendor's exposure to claims that the business is overvalued or underperforming.

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The High Court has also emphasised the role accounting records play in liquidation proceedings. A failure to keep proper accounting records can mask the true financial position of a company, which in turn, may cause the directors to make bad decisions as a result of incomplete or inaccurate information. Proper accounting records are particularly helpful for understanding whether a business is solvent.

Proper accounting records:

- record and explain all the transactions of the company
- will enable the financial position of the company to be determined at any time
- enable the directors to ensure that the financial statements comply with the Financial Reporting Act 1993
- enable the financial statements of the company to be audited.

Other issues raised by the Commission's most recent review include disclosures of transactions with related parties and how unexplained expenses are dealt with by companies.

Kensington Swan offers expertise in advising on disclosure obligations. If you are unsure about your duties as a director or whether your business is complying with its financial reporting obligations, contact one of our experts.

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