SPEAKMAN LAW

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A change of seasons

Then as it was, then again it will be
Though the course may change some times
Rivers always reach the sea
Flying the skies of fortune
Each our separate ways
On the wings of maybe…

I've always liked these lyrics, can you name the song? Perhaps it is just because I like the song; somehow with Summer ending and the onset of Autumn they seem apt to encompass the changes ahead and attitudes towards them.

Welcome to my first newsletter for 2018. So much is happening in the legal front, so much to keep up with, busy times had and busy times lie ahead. I have tried to capture the most pertinent here. As always I trust and hope you find it an enjoyable and pertinent read.

Financial Services Registration…

A key component of the anti-money laundering rules is monitoring of financial services providers by regulators. Inherent in this is the requirement for financial services providers to register under the Financial Service Providers (Registration and Dispute Resolution) Act 2008.

Registration under that Act facilitates investors and intermediaries to access information about financial services providers and generally subjects them to a watchdog process.

Consistent with this watchdog facility, the category of businesses coming within the umbrella of the registration regime is extremely broad. The key activities coming under its scope are financial adviser services, broking services, acting as a deposit taker, being a registered bank, managing or administering money or an investment portfolio, providing credit under a credit contract, and operating a money or value transfer service. Lawyers, accountants and real estate agents are expressly excluded.

What's inside

- Financial Services Registration
- Enforcing Warranty Claims
- Assets v Share Sales
- Overseas Investment – Residential Land
- M&A – How long does sale take?

Briefly – Special Interest/Sport

- CBL placed in liquidation by Reserve Bank; market capitalisation had been north of $750m
- MH370 – the reinstated search for missing plane so far unfruitful, to end in June
- Ireland undefeated in 6 nations, England lost one (Scotland)
- Phil Mickelson wins World Golf Championship, now has 43(!) PGA victories
- Steve Smith, Australian cricket captain, reportedly will earn nearly US$1.5m this year
- Can you name where Commonwealth Games are to be held? They start on April 4.

Briefly – Law

- Cartel criminalisation – criminal penalties are proposed for cartel conduct that is essentially anti-competitive (maximum penalties are a term of imprisonment of 7 years for individuals or a fine of $500,000)
- Trust Law Bill before Parliament – period of trusts to be extended to 125 years, trustees responsibilities to beneficiaries expanded, mandatory and default provisions introduced for trust deeds
- Taxpayer (Chatfield & Co, Accountants) wins judicial review case against Revenue on scope of Revenue's powers to access information from NZ residents on request from a foreign Government

It is an offence to carry on a financial service business without being registered. Penalty for non-compliance is imprisonment and/or a fine.

Financial service providers are also required to be a member of an approved dispute resolution scheme. That requirement applies, however, only where services are provided to retail clients. A retail client is anyone other than a wholesale client being persons in the business of providing financial services and certain large entities.

Invariably a registered financial services provider will be required to comply with the anti-money laundering rules. It is highly likely they will be a reporting entity under those rules with accompanying requirements to carry out risk assessments, have a compliance program, appoint a compliance officer, and arrange auditing of their AML processes.

If you think the financial services regime and/or the anti-money laundering and countering terrorism regime may apply to you or are unsure about it please contact me. Heavy penalties can accompany oversight on this score.

Enforcing Warranty Claims…

Where warranties on a sale of assets are given by a vendor company, financial recourse against that company is important. Not uncommonly the purchaser later wishes to rely on the warranties only to find that the vendor company has been liquidated and there are no available assets to meet the purchaser's claim. Precisely the same concerns accompany vendor trusts.

These concerns can readily be addressed. Often they are addressed by placing a portion of the purchase price in escrow for a period that matches the vendor's liability under its warranties (though vendors who have immediate need for the sale proceeds in entirety will strongly resist this). Deferring payment of the purchase price is another alternative but also likely to be resisted by the vendor. Another option, again disliked by vendors, is an express prohibition against distributions by the vendor (whether it be a company or a trust) during the warranty period.

Vendor opposition to these alternatives, coupled with purchaser insistence for protection has led to proliferation in vendor warranty insurance. Under these arrangements the purchaser's recourse is to the insurance policy and not against the vendor at all.

This frees up the vendor from any restrictions that may otherwise be imposed on its present use of the sale proceeds. It also offers the purchaser confidence that any warranty claim will be met.

Key to the effectiveness of a warranty insurance package is the scope of the policy. Like any insurance policy, the insurer will seek to limit its scope where possible and will be reliant on due diligence assessment of the risks. Expect the insurer's processes in these respects to be fulsome and robust.

I have been involved in a number of warranty insurance deals. They have worked well, though are suited to larger transactions, not smaller ones, given their expense. Carve outs often exist for specific matters; transfer pricing tax risk and existing legal claims often are excluded.

Vendor warranty insurance does not interrupt the usual process between vendor and purchaser of negotiating warranties and limitations on them. Vendors will seek to limit warranties in 3 primary ways:

a. by limiting the time within which a purchaser may bring a warranty claim;

b. by inserting a maximum amount of liability under warranties;

c. by limiting the warranties themselves and introducing knowledge qualifiers (ie liability only to the best of the vendor's knowledge).

These limitations, by extension, reduce the insurer's risk which in turn will affect the insurer's appetite for issuing the policy at all, and its pricing of it. This is a delicate process but one that overcomes significant negotiation hurdles.

If you require further detail about enforcing vendor warranties, please let me know.

Assets v Share Sales…

In any acquisition process the first question is whether it is the assets of a business or the shares that are being sold. Commercially, pronouncedly different results are derived depending on whether it is the shares or the assets being sold.

On a share sale the sale proceeds are received directly at the level of the shareholder. Those proceeds will generally be received tax free and without tax

complications. On an asset sale on the other hand, the sale proceeds are received at the vendor company or vendor trust level and the tax results are very different.

There will be a tax liability where the assets sold are held on revenue account (and also for some capital items, for example financial arrangements). Additionally, there will inevitably be tax complications on distributing the sale proceeds to the owners.

These tax issues can become deal breakers. A hotel for example will inevitably suffer a tax liability on account of depreciation recovered upon an asset sale. For this reason hotel owners invariably insist on a share sale. Equally, financiers often insist on a share sale. That is because the vendor inevitably holds sizeable financial arrangements that will trigger a tax liability for it under the base price adjustment provisions in our tax legislation, making a share sale preferable.

Similarly, on an asset sale, unanticipated negotiation obstacles often surface in the course of allocating the purchase price amongst the assets being sold. The vendor ordinarily seeks to ascribe as much of the purchase price as possible to goodwill, whereas the purchaser will want the opposite. Likewise the vendor will want to ascribe as much as possible to capital assets (usually land) that are not depreciable (avoiding any tax on account of depreciation recovered), whilst the purchaser will want the opposite so as to maximise its depreciation deductions going forward.

From a commercial perspective, on the other hand, most buyers prefer to acquire the assets, not the shares. In that way they are able to select for purchase only desired assets and employees and may leave behind those assets or employees that do not fit their needs. It also facilitates leaving behind liabilities, including unknown and difficult to quantify liabilities for tax or past defective works.

On the other hand, for larger businesses a share purchase is the only practical option due to the large number of contractual arrangements entered into in the course of the business and the impracticality of assigning them. Alternatively, there may be important contracts that are non-transferable or licences that are unique to the vendor. In those circumstances a share sale will be preferred. It is a horses for courses approach whether an asset sale or a share sale is preferred. As a rule of thumb, small transactions often proceed by way of an asset sale and large transactions (particularly those involving listed entities; watch for application of Takeovers Code) often proceed by way of a share sale.

Overseas Investment – Residential Land…

Overseas purchasers of large blocks of rural land have for many years been subject to a consent process under the Overseas Investment Act. That consent process essentially requires the purchaser to demonstrate economic benefits to NZ flowing from the purchaser's investment and continued ownership of the land.

This consent process is to extend to residential land. A Bill was laid before parliament in December to that effect. Under that Bill, residential land is to be treated as "sensitive land". This will mean that overseas persons will generally not be able to acquire a residential house in NZ or bare residential land. The Government's stated objective underlying these changes is to make homes more affordable for NZ buyers while also supporting its efforts to build a more productive economy by helping redirect capital to more productive uses.

Once the Bill is passed, overseas persons will only be able to buy sensitive land that is residential land:

If they will be developing the land and adding to NZ's housing supply;

If they convert the land to another use and are able to demonstrate this would have wider benefits to the country; or

If they have an appropriate visa status and can show they are committed to reside in NZ.

The scope of these new changes is extremely broad. They will apply to overseas persons seeking to acquire residential land for non-residential purposes, for example development of a shopping centre. Equally it will apply to acquisitions of commercial dwellings, such as retirement homes. Accordingly this is a significant extension to the rules requiring consent for overseas investment in NZ.

M&A – How long does sale take?…

Acquisitions nearly always start with a due diligence on the part of the buyer. How long does that take?

Then there is the negotiation phase and following signing, the steps to completion. How long should be allowed for each of these phases? For a seller, the longer the more disruption to the business and cause for loss for it if the deal does not proceed. For the buyer, timing will be driven by its own agendas, proclivity to accept risk, access to finance and consents needed (shareholder approval being required commonly).

Each phase is underscored by the complexity of the transaction and uncovering of issues that surface in the course of due diligence. Usually allow 4 weeks for completion of due diligence; it may be shorter or longer depending on the size of the transaction and especially where environmental reports are required or Commerce Commission considerations (acquisitions that potentially substantially lessening competition in the market) are at play.

The negotiation phase is usually the quickest phase. 2 to 3 weeks is the norm from go to whoa of course it can and often is longer. Often this is effected in tandem with the due diligence process.

Finally, the time needed for completion (once the agreement is signed) should not be underestimated. A lot needs to happen here including obtaining consents from third party licensors, and landlords, releases of bank/financing securities, shareholder or other approvals and handling of employees' contractual matters and entitlements. Parties often underestimate how long is needed for this. My advice is, other than for small/simple transactions, to allow for 4 weeks from signing to completion.

Our Website…

Read our newsletters online at www.speakmanlaw.co.nz.

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