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Litigation Forecast 2021

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Overview

Welcome to our Litigation Forecast for 2021

It wasn't that long ago that a surge of commercial litigation flowing from COVID-19 was anticipated. Contractual disputes relating to the performance or termination of contracts were expected to be litigated and there was a real risk for directors who failed to consider and respond to the risks arising from COVID-19 (in much the same way as climate change poses risks for directors). There were also warnings of mass insolvency.

But the surge in COVID-related litigation never (or has not yet) arrived. While there were certainly disputes between commercial parties, what we saw was business getting on with doing business and taking a pragmatic approach to resolving disputes. The deluge of insolvencies didn't occur either - liquidations for the year to November 2020 were down on the same period in 2019.

With low interest rates, huge government spending (and borrowing) and New Zealand seen as a safe place to invest acting as a buffer to the hard edges of the pandemic for many, we anticipate that the way in which many businesses will manage compliance and disputes in 2021 will have the familiar feel of pre-COVID days, even though the pandemic has changed their risk profile dramatically. Of course, this will not be universal with a number of industries continuing to struggle because of our closed borders, supply chain issues and slowing global growth. A lot of pressure has built up which will need to be released somewhere. We expect business casualties and litigation to flow as a result, but not at the scale anticipated last year, unless of course there are further lockdowns.

Aside from litigation stemming from COVID-related issues, we anticipate increased regulatory actions against companies and directors in 2021:

- the FMA will continue to focus on governance and culture while also playing an active enforcement role in relation to anti-money laundering breaches, where regulatory tolerance for non-compliance is decreasing;
- the progression of WorkSafe's prosecution of three directors of a PCBU associated with the ownership of Whakaari/White Island will bring a renewed focus on officer compliance with their due diligence duty;
- the Privacy Commissioner will work with other regulators to ensure that agencies meet their privacy obligations and are both cyber-secure and resilient;
- the Commerce Commission will be particularly active, including around environmental claims, pricing representations and enforcing limits on the fees and interest that can be charged on high-cost consumer credit contracts. It will also continue to increase awareness of cartel conduct ahead of criminal sanctions from April this year; and
- regulators will continue the increasing trend of investigating and enforcing corporate misconduct.

With the Labour government's absolute majority, we expect immediate changes for many businesses, particularly in the employment sphere. We anticipate a framework for Fair Pay Agreements setting industry-wide minimum standards to be introduced while we understand changes to the holiday framework to be on the cards.

COVID-19, increased regulatory action and legislative change will all shape the litigation landscape in 2021.

If you would like to discuss any of the themes in this report, please contact one of our experts.

Andrew Horne Jane Standage
Partners and Co-leaders of Dispute Resolution

Oliver Skilton
Partner and Editor-in-chief

Insolvency:
A seismically loaded fault line

2020 was a Jekyll and Hyde year for insolvency, both for New Zealand and our closest neighbour, Australia.

In our 2019 Litigation Forecast, we said 2020 would see two significant senior court decisions on directors' duties engaged on insolvency.

- As predicted, the Supreme Court's decision in *Debut Homes* was released in late September. It sent shockwaves through the director community.
- Originally scheduled for April 2020, the Court of Appeal only heard the *Mainzeal* appeal in late July and its decision remains pending at the date of writing.

Otherwise, a relatively ordinary year was expected. We obviously did not foresee the onset of a global pandemic and the lockdowns imposed in response.

The first lockdown caused substantial uncertainty for directors of businesses suddenly starved of revenue. Confronted with a liquidity crisis, directors were unable to assess how the unique circumstances facing them might unfold. As a consequence, most were unable to prepare forecasts and plans on which they could rely to make the informed decisions

Photo: Sandeep Singh / Unsplash

The year panned out very differently than presaged by March and April's lockdown.

the law required for continuing to trade businesses experiencing financial distress. The lockdown's impact foreshadowed carnage across the economy and at the time, large numbers of insolvencies seemed inevitable. With borders shut and the population effectively on home detention, tourism and hospitality businesses were particularly hard hit. Things looked very bleak.

But the year panned out very differently than presaged by March and April's lockdown. The economy exhibited remarkable resilience and the anticipated wave of formal insolvency appointments did not eventuate. Liquidations for the year to November 2020 were 23% down on the same period in 2019[1]. While appointments as receivers and voluntary administrators were up over the same period (by 21% for receiverships and 7% for voluntary administrations)[2], generally these appointments concerned businesses that were already experiencing financial distress prior to the onset of COVID. In contrast to what we saw following the Global Financial Crisis, initial concern about lack of liquidity was supplanted by an abundance of cash and availability of investment capital.

Much of the credit for this is due to the fiscal and monetary policy tools deployed by the Government and the Reserve Bank. Headlining these were the wage subsidy scheme, cuts to the OCR and quantitative easing. Banks also chipped in through assistance to affected businesses and individuals, including waivers and indulgences around covenants and covenant testing and the mortgage deferral scheme. Liquidity was further helped by redeployment of funds intended to be spent on overseas travel to domestic tourism and consumer spending.

Specific legislation was enacted to assist. In particular, a number of measures were introduced by the *COVID-19 Response (Further Management Measures) Legislation Act 2020.* Notable among these were a temporary safe harbour from application of insolvency related directors' duties for directors of COVID-19 impacted businesses and the Business Debt Hibernation scheme (or BDH). For more detail on these and other measures introduced, see our release Government issues relief for directors and companies from insolvency provisions in the Companies Act 1993. In summary:

- The safe harbour gave comfort to directors trading on qualifying businesses in uncertain times provided certain criteria were met; and
- BDH provided cash flow relief for a range of qualifying trading enterprises by preventing creditor action for a month or, with creditor approval, up to seven months. While not itself providing a permanent answer to a financially distressed business, BDH was intended to allow a breathing space to either return to ordinary trading or for more traditional, substantive restructuring processes to be deployed.

The temporary safe harbour regime expired on 30 September 2020. However, BDH, originally to expire on 24 December 2020, was, on 1 December 2020, extended to 31 October 2021. The criteria for both was a business which was able to pay its due debts as at 31 December 2019, which was experiencing significant liquidity issues as a consequence of the impact of COVID-19, and for which it was more likely than not that these could be resolved over a stipulated period. As matters transpired, BDH was relatively underutilised - as at the end of November 2020, only 43 businesses had considered it necessary to seek its protection.

The Australian experience was similar to that of New Zealand.

1. As advertised in the *Gazette*. Liquidations for the first quarter of 2020 (prior to lockdown) had been ahead of those for the first quarter of 2019.
2. As advertised in the *Gazette*. Excluding the first quarter (pre-lockdown period), receiverships were down 8% and voluntary administrations were up 33%

Australia

As part of its regulatory response to the pandemic, the Australian Government introduced temporary measures concerning Australia's insolvency laws in an effort to provide a safety net for businesses facing financial distress as a result of the pandemic. Key to these measures, in the corporate context, were:

- a temporary increase in the threshold at which creditors can issue a statutory demand (increased to $20,000 from $2,000) on a company and the time available to companies to respond to statutory demands (increased to six months from 21 days). Although a different approach to BDH, the intent was the same – to provide affected businesses with a breathing space from creditor action; and
- temporary relief for directors from any personal liability for trading while insolvent.

In place from 25 March 2020 to 31 December 2020, these measures were critical to avoiding a wave of insolvencies. Formal insolvency appointments in Australia dropped in 2020 compared with 2019, by 35% for the year to October[3]. They were on par for the first quarter, before falling away dramatically from April 2020.

The Australian Government has announced that there will be no further extension to this temporary relief, acknowledging that the inevitable cannot be delayed indefinitely. Instead, it has chosen to legislate a significant package of permanent reforms to Australia's insolvency laws, the largest in 30 years. These will be directed at small businesses in response to liquidity challenges faced by many due to the pandemic, and in recognition that current insolvency processes are not generally appropriate for small business insolvencies.

> "As part of its regulatory response to the pandemic, the Australian Government introduced temporary measures concerning Australia's insolvency laws

Under the reforms, which commenced on 1 January 2021, eligible companies (those with liabilities less than AUD1,000,000) are able to access:

- a new formal debt restructuring process to allow a faster and less complex process to restructure existing debts and maximise their chances of survival; and
- a new simplified liquidation pathway to allow a faster and lower cost liquidation process if restructuring is not acceptable to creditors or possible.

However, these reforms will do little to assist larger companies that have suffered significant financial distress, weathering the pandemic only through government support in the form of JobKeeper (Australia's version of a wage subsidy scheme).

3. Formal insolvency appointments across Australia totalled 6,020 for the year to October 2020, compared with 9,298 for the equivalent period in 2019: Australian Insolvency Statistics (ASIC) released December 2020.

Insolvency - Outlook for 2021

Although the New Zealand economy has so far bounced back better than expected, it remains to be seen whether this represents a bullet dodged or a false dawn.

Our expectation is that there will be business casualties as the effects of stimulants such as the wage subsidy scheme and mortgage deferral scheme come to an end. We see the situation as similar to that of a seismically loaded fault line. All may seem well on the surface now, but a lot of pressure has built up and who knows when or where the ground will shake and to what extent.

But while we expect an uptick in insolvency and restructuring activity in 2021, it is unlikely to be the wave originally feared. The impact will likely be felt most by small to medium sized businesses without the resilient balance sheets and capital pathways available to those at the bigger end of town, and particularly by businesses exposed to supply chain disruption or those that rely on tourism or overseas students.

So too with Australia, which has also benefitted from economic stimulus measures and temporary legislative relief and has seen an economic rebound even better than New Zealand. The market there has so far refrained from attempting to predict the extent of business failures following the expiry of their temporary relief. Debtors, creditors and practitioners appear to be waiting for the government support to end before assessing the situation and their response.

Complicating the outlook further for New Zealand is the impact of the Supreme Court's decision in Debut Homes and is discussed in more detail in our release Supreme Court raises the stakes for directors of distressed businesses.

Debut Homes signals little tolerance for directors who continue trading financially distressed businesses rather than pursuing formal insolvency or restructuring procedures, even though they may have best intentions for improving creditor outcomes. The decision has the potential for discouraging genuine corporate rescue efforts in circumstances where current formal processes may not be feasible: voluntary administration is too costly for many businesses and compromises under Part 14 of the Companies Act 1993 lack the protection of a moratorium against creditor action.

It remains to be seen whether the senior courts will seek to contain the impact of *Debut Homes* or smooth its sharper edges in future decisions. The first indication will be the Court of Appeal decision in *Mainzeal*.

Ultimately though, substantive legislative adjustments may be necessary to restore directors' confidence already shaken by the extraordinary events of 2020 and/or provide more feasible restructuring pathways. Options include:

- a permanent safe harbour for directors generally exploring restructuring options, as exists in Australia;
- providing the protection of a moratorium against creditor action for Part 14 Companies Act compromises; and
- following Australia's lead in introducing a simpler formal debt restructuring process, at least for smaller companies.

D&O Insurance:

Increasingly costly and uncertain

Many companies and their directors, particularly dual-listed companies whose shares are quoted on both the NZX and ASX, have been astonished at the difficulty and cost of renewing their Directors and Officers (D&O) insurance in the past year. This is a trend that we view as likely to continue, particularly at the top end of the market, as insurers face an uncertain and increasingly risky claims environment while at the same time, capacity in the London insurance market continues to tighten. We are working with large, listed companies that are actively exploring ways to manage or limit their D&O insurance expenditure.

Photo: Sander Weeteling / Unsplash

What is happening

Many companies are experiencing 'shock' D&O premium increases that in some instances have been many times multiples of their previous year's premiums. Dual listed companies have been particularly affected and some are reported to have considered de-listing in Australia in order to bring their costs under control. Companies that are listed only in New Zealand are also experiencing substantial premium increases and some are having difficulty arranging replacement cover if their insurers are among those that have left the D&O market.

There are a number of reasons for this, which when combined create a 'perfect storm'.

1

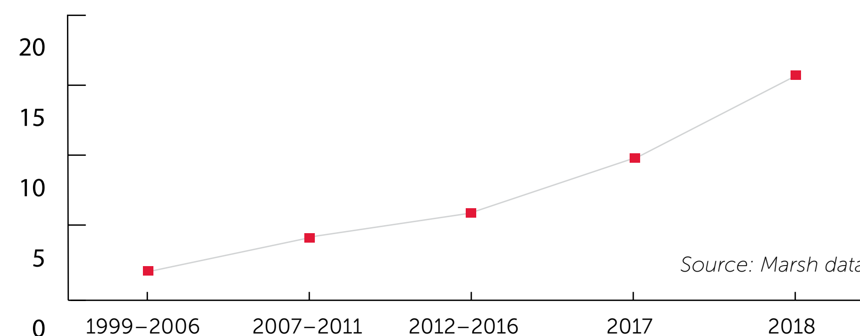
The exponential growth in the number and size of funded securities claims that has been experienced in Australia in recent years.

Insurers rely upon historical trends and informed assumptions for actuarial calculations that inform their estimates of likely claims, to set premiums. They have been caught off guard by a sudden and exponential increase in the number of securities claims against directors brought as group or 'class' actions on behalf of large numbers of affected investors, funded by third party litigation funders and supported by specialist lawyers.

The cost of dealing with these claims has increased proportionately, as has, necessarily, premium costs. The known rise in claims costs is exacerbated by insurers' increasing uncertainty as to what the future holds, which has caused them to increase premiums further to guard against unknown further increases in the number and size of claims.

> "The cost of dealing with funded securities claims has increased proportionately, as have premium costs.

NUMBER OF SECURITIES CLASS ACTION CLAIMS IN AUSTRALIA
PER ANNUM AVERAGE



Exponential nature of the increase in claims as appeared in a recent article co-published by our firm, insurance broker Marsh and the Institute of Directors

D&O insurance was traditionally a relatively low-cost addition to a company's suite of policies.

2

A D&O premium base that historically has not kept up with claims costs.

D&O insurance was traditionally a relatively low-cost addition to a company's suite of policies that was offered as part of an overall package. In the distant past, directors were obliged to pay for the cost of this insurance themselves, which encouraged insurers to offer it at a very low cost on the basis that they would earn their profits from the premiums for the wider policy suite. Insurers now have no option but to charge D&O premiums that fairly reflect the risk of claims and losses.

3

Insurers' apprehension that the New Zealand legal environment is beginning to adopt some of the features of the Australian environment that has resulted in increased numbers of group litigation proceedings and securities claims.

As we discuss further in the next article, the New Zealand Supreme Court has recently approved 'opt out' representatives or 'class' actions where a law firm and a litigation funder may act on behalf of a large group of investors or other affected persons without their express consent, provided they do not object, thus making it considerably easier to bring a claim on behalf of a large number of people with the same interest in a claim. These actions lend themselves particularly to securities claims where investors may have been misled, or continuous disclosure claims where investors may have overpaid or been underpaid for shares. In addition, litigation funding by third parties for a share of the proceeds of an action is increasingly accepted.

We are beginning to see professional litigation funders being increasingly active, although we have not seen firms of class action lawyers emerge with the level of sophistication that exists in Australia.

While class actions in New Zealand remain relatively rare, they are increasing in number. In recent years, there have been group actions against the directors of a carpet manufacturer, Feltex; an insurer, Southern Response; a building supply company, James Hardie; the Ministry of Primary Industries; the directors of Mainzeal and the former directors of CBL Insurance. While New Zealand does not yet have a sophisticated class action regime, the Law Commission's class action reform project has recently been reinvigorated.

However, important differences remain between New Zealand and Australia. New Zealand is a much smaller market and claims are for the large part commensurately smaller, so they are less likely to justify an investment by lawyers and funders. New Zealand has activist regulators in the NZX and the FMA which investigate and seek remedies for continuous disclosure breaches and other securities breaches, rather than leaving them to the private funding market. This may have the effect of discouraging private litigants when the regulators do not view a case as worthwhile.

Dual-listed companies are not as exposed to Australian litigation as it might appear, as they are obliged to comply with New Zealand laws rather than Australian laws and litigation against them is likely to need to be brought in New Zealand. These and other features mean that New Zealand is less able to support a community of lawyers who specialise in claims of this nature. While there have been recent high-profile actions such as the proceedings against the Mainzeal directors, in which our firm acted for the successful plaintiffs (with the Court of Appeal decision yet to be released), they tend to be liquidators' actions that have traditionally been pursued and funded in any event.

4

The reduction in capacity in insurance markets for D&O risk.

Lloyd's of London has traditionally issued a large proportion of the higher 'layers' of high value New Zealand D&O policies, where the primary layer has been written locally and excess layers have been written out of London. This capacity is reducing as Lloyd's has increasingly required its syndicates to demonstrate their solvency and their ability to operate profitably, failing which their books have been closed. This has resulted, inevitably, in a reduction of capacity and a corresponding reduction of availability of cover and increasing premiums.

It is also relevant that other liability risks are perceived as increasing. Regulatory actions against companies and directors appear to be on the increase, with the FMA being increasingly well-funded and well-staffed. The FMA's focus remains on the conduct of directors and senior management. Following its Bank Conduct and Culture Review in November 2018, the FMA and the Reserve Bank of New Zealand said that they would be:

".. expecting to see much deeper accountability of boards, executives and senior managers. We will be looking for progress and clear evidence of change and want to see this become part of the ethos of all banks in New Zealand."

New risks are also emerging which are difficult to predict. In a recent article, three judges of the New Zealand Supreme Court, writing on Climate Change and the Law, addressed directors' risks with the following statement:

'Directors have a duty to consider the "best interests" of the company in all of the colloquium jurisdictions. It remains to be seen how climate change impacts that duty. As we discuss, there have already been cases in Australia and the United Kingdom relying on corporate governance and company law to hold companies to account for their climate impacts and actions.'

While acknowledging that New Zealand companies legislation does not expressly require directors to consider the impact of operations upon the environment, the judges said that:

'As a material financial risk, directors are accountable under care and diligence duties to take account of the financial consequences of climate change and this applies whatever model of corporate governance is subscribed to. Further, the "business judgement rule" would not protect directors where the legal risk stems from inadequate information or lack of inquiry.

Regulatory actions against companies and directors appear to be increasing.

What companies may do to improve their positions

Insurers need to understand the specific risks that a company and its directors face and how they are managing those risks, to build confidence that they may accurately assess the risk of losses. We find that insurers often assume initially that New Zealand companies face the same risks as their Australian counterparts when this is not the case. We have seen positive outcomes where companies and their directors have presented insurers with a well-considered statement of the risks they apprehend and how they are addressing them, with an explanation, if appropriate, of why those risks are not viewed as comparable with those faced by companies in Australia or elsewhere.

Class actions and litigation funding: Progress at last

Class (or representative) actions have continued to increase, both in frequency and size, over recent years. This has put sustained pressure on insurance for prospective defendants and together with an increased insolvency risk profile has put even more pressure on directors.

Twelve months ago, in our last forecast, we reflected on progress in New Zealand's class action and litigation funding landscape and predicted further developments. Despite unprecedented unpredictability, we have seen two major steps to progress New Zealand's class actions and litigation funding regime in 2020

- "Opt-out" orders are now here to stay, following the Supreme Court's November 2020 decision in *Southern Response Earthquake Services Limited v Ross* [2020] NZSC 126.
- The Law Commission has published its substantive, and substantial, Issues Paper for its Class Actions and Litigation Funding project.

We predict that 2021 will see the courts continuing to focus on managing class actions while the Law Commission presses ahead with its recommendations for a statutory class action regime (having come to a preliminary view that New Zealand should develop one) and for the potential regulation of litigation funders (which are a necessary part of the majority of class actions).

Photo Genessa Panainte / Unsplash

Southern Response Earthquake Services Limited v Ross

In September 2019, the Court of Appeal issued what was a landmark decision. It permitted, for the first time, "opt-out" orders for representative actions in New Zealand. The Supreme Court then upheld the Court of Appeal's decision.

Both parties had accepted that the existing rules allowed for "opt-out" orders by the time the case reached the Supreme Court.

However, Southern Response contended that it was not appropriate to make such orders in the absence of a legislative framework governing representative actions.

The Supreme Court provided the following guidance for when "opt-out" orders should be made:

- Generally, the court should adopt the applicant's chosen procedure unless there is good reason to do otherwise.
- In terms of departures from the above starting point, an "opt-in" approach should be favoured where there is a real prospect that some class members may be worse off or adversely affected by the proceeding. Cases where there is a counterclaim or the potential for one to emerge would fall into this category. Class size is relevant, with smaller classes with existing connections between members favouring an "opt-in" approach.
- A universal class (where notice is not required, and class members do not have the chance to opt in or out) may be appropriate where the relief sought, such as a declaration, impacts all class members equally.
- The Court can supervise settlement of representative actions, to ensure fairness to class members in terms of the outcome and consequences of settlement. Representative order applications should address the court's supervisory role in this regard.

> In September 2019, the Court of Appeal issued what was a landmark decision for representative class actions.

Law Commission's Issues Paper in its Class Actions and Litigation Funding project

The Law Commission spent 2020 progressing its Class Actions and Litigation Funding project.

Having initiated conversations with key stakeholders, the Law Commission decided on a first principles-based review process, primarily because:

"It is evident from [the Law Commission's] initial conversations and research that there is no broad consensus on the desirability of a class actions regime or litigation funding, nor on the extent to which, or how, they should be regulated."

The Law Commission's recent work has culminated in a mammoth 376-page Issues Paper to: '... facilitate consultation and feedback on whether the potential benefits of class actions and litigation funding can be realised in a way that outweighs any risks and concerns.' The Issues Paper is evenly divided between class actions and litigation funding.

Class actions

The key to the Issues Paper is the Law Commission's preliminary view that New Zealand should have a statutory class actions regime. The Law Commission considers that class actions provide valuable access to justice and that any disadvantages in the current system (which it considers inadequate) can be managed in a statutory regime. The goal of any regime is to "provide greater certainty, predictability and transparency of the law".

The Law Commission is now focused on the issues that will need to be addressed if New Zealand is to adopt a statutory class actions regime. Key issues include:

- Whether each case must be certified to proceed as a class action i.e. what basic requirements must be met. In our view, any regulatory regime will need to ensure that the preconditions to class actions do not present an insurmountable barrier to entry. The regime must provide ready access to justice to allow plaintiffs with meritorious actions to have their grievances determined expeditiously.
- Who can be a representative plaintiff, including the role of tikanga in determining questions of mandate in representing groups of plaintiffs, as well as class membership. Again, we think that these are important issues, particularly in ensuring that New Zealand's legal processes are consistent with tikanga.
- Management of adverse costs where class actions are unsuccessful. It will be important that costs issues are regulated to ensure fairness to both plaintiffs and defendants.

We maintain that a well-developed statutory regime would assist access to justice. It would provide clarity on the requirements for class actions, while also removing the high cost associated with the proceedings currently necessary to settle procedural rules.

Sophisticated funders provide a valuable service.

Litigation funding

The Law Commission's preliminary view is that *"… litigation funding is desirable in principle and should be expressly permitted, provided that.."* concerns can be managed:

- Funder control of litigation – the key concern being one of interest misalignment between funders and plaintiffs. The Law Commission has said that the courts retain a supervisory jurisdiction over their own process. One option would be the mandating of minimum contractual terms as to funder control.
- Conflicts of interest – both as between the funder and plaintiffs (e.g. where one wants to settle and the other does not) and between the plaintiffs and their lawyer(s) (e.g. where the lawyer's proximity to, and/or reliance upon, the funder creates a conflict). The Law Commission has suggested the possibility of minimum contract terms in funding agreements regarding conflict management.
- Funder profits – funding is a given that it is generally no-recourse i.e. the funder does not get repaid its outlay or commission if unsuccessful. While recognising that economic reality, the Law Commission has considered options to mitigate the risk of super-profits and the impact that such an outcome could have on substantive justice for plaintiffs. *"Options… include facilitating increased competition in the litigation funding market, court supervision of funder commissions and direct regulation of the amount of permissible funder commissions."*
- Capital adequacy of funders and funder regulation – the Law Commission has highlighted the risk to plaintiffs (and therefore justice) if funders do not maintain adequate capital reserves to ensure that proceedings, and costs consequences, can be funded throughout the course of the litigation. Options for reform include amendments to the security for costs regime that would require funders to provide security for defendants' costs and/or mandating capital requirements for funders, depending on the type and nature of the proceeding.

Tied to the above concerns is the Law Commission's preliminary view that funders should be regulated. The express manner of regulation is the subject of discussion, with the Law Commission recognising that there is no global standard. Self-regulation is an option, as well as more formal financial services regulation.

In our view, any funder regulation must ensure the right balance between protecting litigants' (and the public's) interests, while at the same time ensuring access to justice. Sophisticated funders provide a valuable service, as many class members are unable (or unwilling in many cases) to put their own money into proceedings. So long as there is a group of funders prepared to take that risk then, consistent with the Law Commission's preliminary view, we see litigation funding as desirable.

Next steps and timing

It appears that the Law Commission will remain busy in 2021, with submissions or comments on the Issues Paper open until 11 March 2021.

The Law Commission will then take this feedback into account as it develops recommendations. Further consultation is expected, with a final report to the Minister of Justice expected in May 2022.

We also expect to see further case law on class action procedure while the law reform process runs its course.

Financial services and insurance:

Regulator expectations high

Regulatory change continues essentially unabated in the financial services and insurance sector, despite COVID-19. This means sustained litigation risk in the coming years.

The regulators have also sent clear signals that their expectations are high, and that 'bedding in' periods are now over in a number of key areas. This is particularly so in the areas of governance and culture, and AML/CFT.

Governance and culture

The Financial Markets Authority's top strategic priority is governance and culture, and they now expect customer needs to be a constant focus for financial services organisations. Where significant breaches of the rules are identified, or where entities are not addressing the FMA's recommendations in an appropriate or timely way, they will take "increasingly strong" action as outlined in the September 2020 Supervision Insights Report. Although further legislation is still to come in this area (notably, the Financial Markets (Conduct of Institutions) Amendment (COFI) Bill), there is now sufficient guidance available to the sector such that the FMA considers there are "no excuses" for conduct which causes harm to investors and customers. The FMA also continues to have a keen interest in what is happening with financial services regulation in Australia. We often see requests for information/investigations arising out of events in that jurisdiction. The FMA is also becoming less receptive to settlements out of court where they perceive customer harm has occurred.

The Reserve Bank of New Zealand has similarly indicated it is reviewing its enforcement framework and "increasing the intensity of its supervision". Greater resourcing of the Reserve Bank, with a new five-year funding agreement, is also likely to result in heightened regulatory oversight. Directors should also take note: increased executive accountability is now planned for incorporation into the planned Deposit Takers Bill expected to be introduced at the end of 2021.

With conduct also a workstream priority for the Council of Financial Regulators, which is set to obtain statutory recognition under the Reserve Bank of New Zealand Bill, the overall picture is one of increased co-operation and co-ordination amongst financial sector regulators. Developments over the last several years mean the financial services sector is now firmly on notice that organisations must ensure they identify and remedy any weaknesses around governance, culture and customer-focus, or they may well find themselves facing regulatory action.

Announcing charges in June 2020 against CLSA Premium, the FMA noted that it was "imperative" for firms to ensure they were compliant with the AML/CFT regime. "*The regime has been in place since 2013 and CLSAP's alleged breaches are serious so it is appropriate for the FMA to take a strong regulatory response. CLSAP NZ needs to be held to account and our approach sends an important message of deterrence to the industry.*"

Insurance sector reforms have been slower to materialise than anticipated.

AML/CFT

Anti-money laundering is another area where regulators' tolerance for breaches is decreasing.

AML/CFT enforcement activity continued during 2020, including:

- one formal warning and six private warnings reported in April 2020 by the FMA for AML practices;
- civil proceedings filed by the FMA against brokering and financial advice firm CLSA Premium in June 2020;
- civil penalties totalling NZD7.585 million imposed against two money remitters in proceedings brought by the DIA;
- two banks' compliance with the AML/CFT Act referred to enforcement by the Reserve Bank as at November 2020, with prescribed transaction reporting continuing to be a focus area; and
- the first criminal sanctions imposed in the case of Jiaxin Finance Limited.

  For Jiaxin Finance, as well as a NZD2.55 million fine for the company, the High Court considered it important for deterrence reasons to impose fines (of NZD180,000 and NZD202,000) on the two individuals responsible for the company's conduct. The offending in Jiaxin occurred at a relatively early stage in the AML/CFT regime when there was some "confusion in the marketplace" about the obligations, and the fine imposed was less than that in two previous civil penalty cases.

However, with the AML/CFT regime now fully implemented, companies should expect both a greater likelihood of regulatory enforcement action and stiffer penalties where there is deliberate non-compliance. That is particularly so given the Financial Action Task Force (FATF) report on New Zealand's AML practices due in early 2021, which is expected to identify further areas for improvement. The record AUD1.3 billion fine agreed in September 2020 between Westpac Banking Corp and the Australian regulator AUSTRAC for failures to report international transactions and insufficient monitoring of customers making suspicious transactions underlines the seriousness with which regulators worldwide are taking AML/CFT compliance. New Zealand reporting entities should take notice.

Insurance

Insurance sector reforms have been slower to materialise than anticipated, although in late 2020 the Insurance (Prudential Supervision) Act 2010 (IPSA) review was relaunched and will continue in parallel with a review of insurer solvency standards. The MBIE Insurance Contract Law review appears to be ongoing, with an exposure draft Bill for consultation now scheduled for release for consultation in mid-2021.

Complementing these intended reforms, the Insurance Council of New Zealand (ICNZ) launched its updated Fair Insurance Code in April 2020. This sets out industry best-practice standards for ICNZ members, placing broad new duties on insurers and strengthening compliance mechanisms. Despite the delays to the COFI Bill and Insurance Contract Law review, the trend is inexorably towards increased requirements on insurers to better serve customer needs and monitor and remedy any breaches.

Anticipated key legislative developments for 2021

- Financial Services Legislation Amendment Act 2019 (and supporting disclosure regulations) new start date of 15 March 2021
- Passage of Reserve Bank of New Zealand Bill in second half of 2021
- Introduction of a Deposit Takers Bill (consultation draft and bill in third quarter of 2021)
- Passage of Financial Markets (Conduct of Institutions) Amendment Bill – currently awaiting second reading
- (Potentially) an Insurance Contract Law Review exposure draft Bill by mid-2021

Climate change litigation: New risks for companies and directors

In our last forecast, we noted widespread acceptance of the existence of anthropogenic climate change and the possible legal consequences as a defining issue of our time. We reported that climate change litigation against private companies had arrived in New Zealand with the commencement of High Court proceedings by a climate change activist, Mike Smith, against Fonterra and six other companies.

A year on, the *Smith* case continues with the defendant companies being successful in striking out two of Mr Smith's three claims in the High Court. The claims in public nuisance and negligence were struck out but a claim based on a supposed new tort asserting that there is a legal duty not to contribute to dangerous interference in the climate system was not. As we expected, this decision was appealed in every respect. The appeal is to be heard by the Court of Appeal in early 2021.

This article looks at the High Court's decision in the Smith case. We also look at climate change related litigation in Australia, which has taken a different approach, and consider the possibility of similar claims in New Zealand.

The High Court decision in *Smith*

In summary, the High Court made the following rulings:

- The claim in private nuisance was struck out for two reasons: Mr Smith lacked standing (because he could not prove special damage to his particular interests) and he was unable to prove an essential factual assertion that the defendants' actions caused him loss. The Court determined that he "cannot responsibly assert that any one of the defendants, or even all of them, has materially contributed to climate change" because their contributions were impossible to determine or measure.
- The claim in negligence was also struck out. The primary reasons for this were that the damage Mr Smith claimed to have suffered was not a reasonably foreseeable consequence of the defendants' actions and that the parties' relationship was not sufficiently proximate for a duty to arise. The Court was heavily influenced by the existence of a detailed legislative regime to address climate change and the concern that the pleaded claims would cut across it.
- The claim in a proposed new tort, asserting a duty not to contribute to dangerous interference in the climate system, was not struck out. The Court declined to do so primarily because, as a proposed new tort, its novelty meant that it ought to be properly considered at trial where all the relevant facts could be determined.

Australia is yet to see a '*Smith*' type of case, where an individual claims to have suffered particular harm as a result of a defendant's emissions.

Australian claims

Australia is yet to see a '*Smith*' type of case, where an individual claims to have suffered particular harm as a result of a defendant's emissions. Instead, Australian climate change litigation has primarily arisen in cases in which investors contend that there has been inadequate disclosure of the effect of climate change on their investments.

Summary of recent Australian cases

O'Donnell v Commonwealth of Australia

In July 2020, Ms O'Donnell filed a claim in the Federal Court of Australia alleging that Australian investors trading in Government bonds would face "material risks" because of the Australian Government's response to climate change and this was not disclosed to investors. In particular, she alleged that, by failing to disclose climate change risks to investors like her, the Commonwealth of Australia breached its duty of disclosure and was misleading and deceiving investors. The case is still making its way through the Courts, with no decision released yet.

McVeigh v Retail Employees Superannuation Trust

Another claim concerning the failure of disclosing climate change risk was brought against the Retail Employees Superannuation Trust (REST), one of Australia's largest asset owners. The claimant alleged that REST's failure to disclose climate-related risk and its plans to address it breached legislation governing superannuation funds and corporations. The claim was settled at the eleventh hour before the hearing, with REST releasing a media statement agreeing to take further active steps to consider, measure and manage financial risks posed by climate change.

Abrahams v Commonwealth Bank of Australia

Shareholders of the Commonwealth Bank of Australia (CBA) alleged that it violated the Australian Corporations Act 2001 by failing to disclose climate change related business risks in its 2016 annual report. The claim was withdrawn when CBA included a summary of climate change related business risks in its 2017 report.

Outlook for New Zealand

Are the same types of claims coming to New Zealand?

We think that New Zealand companies should be prepared for similar claims. We see no reason in principle why they could not be brought here, although specific disclosure obligations will differ in various circumstances. The Council of Financial Regulators, a forum for agencies with responsibility for financial regulation, has included climate change and the facilitation of a smooth transition to a low-carbon and climate-resilient economy as one of its priorities.

How could these types of claims be made against New Zealand companies and directors?

Directors duties and claims under the Companies Act 1993

As noted in our last forecast, where directors fail to consider and respond to climate change risks that cause harm to a company, they could face claims that they breached reporting obligations and duties of care, including those arising from the risk of regulation, penalties and brand damage to the company, among others. These appear to be the primary risks arising from potential climate change claims and the Abrahams case serves to highlight these risks for New Zealand directors.

Misleading and deceptive conduct claims

Both the Financial Markets Conduct Act 2013 and the Fair Trading Act 1986 may offer avenues for investors and consumers to hold financial service providers and other persons in trade to account. Like O'Donnell, failure to disclose climate change risks to investors and consumers may result in a claim for misleading and deceptive conduct in New Zealand.

Trust-related claims

As in McVeigh, New Zealand investment and superannuation trust schemes may be exposed to potential litigation under the Trusts Act 2019. Under sections 29 and 30 of that Act, trustees owe a general duty of care and a duty to invest trust property prudently. A failure to account for climate-related risks may give rise to a claim by a beneficiary for failure to exercise reasonable care and skill in the administration of the trust.

On the horizon

A proposed new climate-related financial disclosure regime announced in September 2020 may soon provide a further avenue for enforcement. Under the proposed regime, entities within its scope will be required to make annual disclosures covering governance arrangements, risk management and strategies for mitigating any climate change impacts. Failure to comply with these reporting obligations may expose entities to enforcement action by the Financial Markets Authority.

Where to from here?

We see multiple avenues for climate change litigation in New Zealand in 2021 and beyond. While the civil tort claims made in the *Smith* case may not survive the appeal, the Australian examples show that there are other avenues that will continue to pose risks.

> We think that New Zealand companies should be prepared for climate change-related claims.

Cyber and privacy risk:

Back in the spotlight

The Zoom meeting walls and chat rooms, COVID tracer apps, and work from home requirements of 2020 have elevated technology and privacy issues to a whole new level of consciousness across our business and private lives.

Coupled with New Zealand's now in force Privacy Act 2020, and ongoing global trends towards harsh penalties for those in breach of data protection laws, 2021 looks set for New Zealand to finally join the march towards greater privacy and cyber risk management and enforcement.

We have observed for some years now the exponential increase in data being collected, held and processed across New Zealand organisations. The 2020 technology boom from working from home has only exacerbated this growth, both for personal information and valuable commercial data. To cope with volume and market demands, businesses have transitioned, at pace, to digital platforms, e-commerce solutions, and digital storage of information. The pace of this transition is not slowing.

It is hardly surprising then that cyber-attacks and data breaches are now regular news. CERT NZ reported 3,102 "cyber security incidents" during the six months to the end of June 2020; an increase of 42% on the same period last year. In April 2020 alone (when New Zealand was in lockdown), 820 incident reports were received. This was the highest monthly number of incident reports since the agency was established in 2017. In Quarter 3 2020, CERT received a total of 2,610 incident reports, a 33% increase from Quarter 2.

With the Privacy Act 2020 in play, we expect to see a tangible increase over the next 12-24 months in privacy enforcement actions in New Zealand. This is particularly as a result of mandatory breach reporting and other enforcement mechanisms designed to give more power to New Zealand's regulator, the Office of the Privacy Commissioner. The reforms increase litigation risk for New Zealand agencies and any agency that carries on business in New Zealand and will impact on the way that organisations conducting business in New Zealand manage privacy issues and data security.

Global trends

If overseas trends are replicated in New Zealand, the Office of the Privacy Commissioner will have its work cut out for it.

Australia

In Australia, the Office of the Australian Information Commissioner (OAIC) reported an 11% increase in notifications under their notifiable data breach scheme from 2018-2019 (950) to 2019-2020 (1,050). The OAIC also launched its first civil penalty action against Facebook this year, for the This is Your Digital Life app.

United Kingdom

In the UK, the Information Commissioner's Office (ICO) handed down two of the largest fines relating to a data breach in UK history. On 16 October 2020, the ICO fined British Airways GBP20 million (NZD25.8 million). Two weeks later, on 30 October 2020, the ICO fined Marriott GBP18.4 million (NZD23.7 million).

The British Airways fine represents the largest fine imposed to date for a breach of the General Data Protection Legislation (GDPR). However, both the British Airways and Marriott fines represent a reduction of nearly 90% and 81% respectively of the proposed fines. This demonstrates the ICO is willing to reduce fines where organisations demonstrate effective mitigations and remedial actions. Regulators in other jurisdictions have not taken such a friendly approach. In Germany, H&M recently received a EUR35 million fine for excessive monitoring of employees in its service centre in Nuremburg.

> "The Office of the Privacy Commissioner will enter 2021 (and beyond) with a renewed focus, and some increased resources to match.

Regulator cooperation

The penalties under our Privacy Act are substantially smaller than other jurisdictions (the new financial sanctions max out at NZD10,000). This makes it likely we will see a reasonable level of cooperation between New Zealand regulators on the approach to privacy and cyber security to meet public expectations of data protection laws.

We noted last year that the Commerce Commission was starting to turn its focus to privacy breaches as a consumer protection issue. At the first International Association of Privacy Professionals Australia and New Zealand summit in Sydney (in 2019) the Privacy Commissioner acknowledged that here, data protection laws alone may not be enough to combat the potential harms. He has queried whether we need more agile consumer protection mechanisms to enable privacy regulators to work together with consumer safety regulators. There is certainly scope for the Commerce Commission to flex its enforcement powers to ensure that consumers' personal information is not used in misleading or deceptive ways under the Fair Trading Act.

Additionally, the Privacy Commissioner may look to the Financial Markets Authority (FMA) for support on enforcement and ensuring that agencies regulated by the FMA have sound privacy practices to protect both organisations and consumers of financial products. We have seen some activity in this area with the FMA issuing Section 25 Notices in the last 12 months to gather information on privacy and cyber security practices.

Australia has already taken steps in this direction with the Australian Securities and Investment Commission Action (ASIC) commencing proceedings in the Federal Court of Australia against RI Advice Group Pty Ltd (RI), an Australian Financial Services (AFS) licence holder, for failing to have adequate cyber security systems. ASIC alleges that Frontier Financial Group, an authorised representative of RI, was subject to a "brute force" attack whereby a malicious user successfully gained remote access to Frontier's server and spent more than 155 hours logged into the server, which contained sensitive client information including identification documents. ASIC alleges that RI failed to implement adequate policies, systems and resources which were reasonably appropriate to manage risk in respect of cybersecurity and cyber resilience.

ASIC is seeking declarations that RI contravened provisions of the Corporations Act, along with compliance orders that RI implements systems that are reasonably appropriate to adequately manage risk in respect of cybersecurity and cyber resilience and provide a report from a suitably qualified independent expert confirming that such systems have been implemented.

Strategic focus

The Office of the Privacy Commissioner has entered 2021 (and beyond) with a renewed focus, and increased resources to match. We expect there will be a dual education/litigation focus at first (with emphasis on education in particular during 2021), giving agencies some time to bed in the requirements of the Privacy Act.

However, we anticipate that the Privacy Commissioner will be keen to send a strong message on compliance and look for appropriate cases to enforce the Act's new standards. We also envisage that the Commissioner will work with other, heavier, regulators to ensure agencies that conduct business in New Zealand meet their privacy obligations and are both cyber-secure and resilient.

Employment:

A year of challenges for employers and employees

2020 was a year full of challenges for employers and employees alike. We expect 2021 to be no different. We anticipate increased litigation in a number of key areas with workplace issues arising out of the COVID-19 pandemic, the shifting labour market, and changes in working arrangements continuing to lead to status disputes before the courts. We also expect further changes to employment legislation.

Litigation arising out of COVID-19

As workplaces continue to feel the economic effects of the pandemic – and as the long-term impacts are starting to set in – we expect employment related litigation to increase in the coming year. We think much of this litigation will come about from restructurings leading to redundancies. Employers have strict obligations under the Employment Relations Act 2000 that require them to observe good faith consultation processes when proposing to disestablish roles. Businesses that attempt to take shortcuts in this proces open themselves up to legal risk.

We also anticipate that disputes about employee pay entitlements will continue to roll out before the courts. In particular, we expect to see more test cases addressing the intersection between the wage subsidy, employment law, and the wage work bargain.

Status disputes and the dependent contractor

As our labour market trends closer towards a gig economy, and as the traditional master-servant distinction loses relevance in today's working arrangements, we predict status disputes will come to the fore of employment litigation. Businesses that shun the employment relationship and engage workers through labour-hire and contracting arrangements will need to follow developments closely as workers seek greater protections and better working conditions.

Given evolving work arrangements, the Government has flagged introducing a statutory regime for dependent contractors in 2021. This new category of worker, which sits between employment status and independent contractor status, may prove to be a watershed in status litigation. Under the current law, employees have statutory employment rights such as minimum wage protections, leave, and rest and meal breaks. Contractors, on the other hand, are protected only by the terms they negotiate in their agreements. The Government's proposal would create room for certain contractors, deemed to be dependent contractors, to demand certain rights which are similar to those in employment relationships.

Employment legislation

Overlapping with status disputes, we anticipate 2021 will see litigation under the new triangular employment laws. These laws enable employees, in certain circumstances, to join a "controlling third party" to a personal grievance claim. The triangular employment regime came into force in early 2020 and is yet to be tested by the courts. However, we expect claims against third party businesses to arise in the coming year.

Following the introduction of the Equal Pay Amendment Act 2020, we expect to see an increase in litigation on pay equity issues. The Act lowers the bar for workers to raise pay equity claims and provides a streamlined process for progressing them. We think that this legislation will have significant implications for employers in traditionally female-dominated industries. In addition, the current backlog of equal pay cases may be repleaded as pay equity claims to be advanced under the new Act.

Though 2020 saw little movement around Labour's Fair Pay Agreement (FPA) policy, a likely consequence of the party's re-election is that a framework for FPAs will be introduced in the next year. FPAs are agreements that set industry-wide minimum standards. We expect that the implementation of FPAs will see an upsurge in union activity.

We also believe that changes to the holiday framework is on the cards. In 2018, the Government established a taskforce to review and provide recommendations to improve the Holidays Act. The taskforce has reported back to the Minister for Workplace Relations who is now considering its recommendations.

Health and safety:
Beyond compliance

Even though the Health and Safety at Work Act has been in force since April 2016, WorkSafe has recently observed that "too many organisations remain locked in a 'legal obligation' mind set".

WorkSafe is therefore challenging organisations to think beyond health and safety as a compliance exercise and start conversations around the concept of "better work" to create the safest workplaces possible. This will require directors and workers at all levels of an organisation to demonstrate real health and safety leadership and encourage worker engagement. When they do, we will start to see safer workplaces.

In encouraging "better work" in 2021, WorkSafe will be continuing to educate businesses on how to make workplaces safer as well as enforcing the Act. It will hopefully be able to do so without the backdrop of COVID-19 and lockdowns which dominated the health and safety landscape in 2020.

TRADITIONAL IMPROVEMENT EFFORTS	BETTERWORKNZ METHOD
Starts with 'what's wrong'	Starts with 'what to grow'?
Compares with an ideal of what should happen	Invites deeper learning about what is driving performance
A few individuals gets to say what solutions should be in place	Builds community and connections between people
Responses are developed for each problem	Risk management is integrated into how work is done
Locks organisations into reactive management	Enable organisations to take steps toward the future they desire
Zero deficits is the goal	Capacity to work successfully across varying conditions is the goal
The future is created based on problems of the past	The future is created based on strengths and possibilities

Source: betterwork.nz/hubbub/communitypage/24611

Further officer investigations and prosecutions

At the end of 2019 and in 2020 we saw the first officers sentenced under the Act for failing to meet their due diligence duties, albeit in relation to closely held companies. This signalled the start of a trend by regulators, including Maritime New Zealand and the Civil Aviation Authority, to look more closely at officer compliance with their due diligence duties. In addition to the prosecutions of three directors of a person conducting a business or undertaking (PCBU) associated with the ownership of Whakaari/White Island, we understand that there are other prosecutions involving officers currently working their way through the Court system. Now that the period of educating officers of their due diligence duties under the Act is well and truly over, we expect the trend to investigate and prosecute officers to continue.

Broader Harm Prevention

Increased levels of remote working in 2020 led businesses and WorkSafe to place a greater emphasis on the mental health of workers and wellbeing risks. We anticipate that this will continue with many workers in the corporate sector, in particular working remotely at least some of the time.

Focus on Maori and Pacifika health and safety performance

WorkSafe is concerned about the higher rates of harm and exposure to risk experienced by Maori, Pacifika and migrant workers. As part of its Maruiti 2025 strategy, WorkSafe is working with these communities on harm prevention initiatives. In turn, we have seen many businesses implement strategies to monitor and improve Maori and Pacifika health and safety in their workplace. We see this positive trend continuing.

Greater emphasis on vehicle-related harm

We expect WorkSafe to focus on risks that continue to be a factor in serious harm incidents, such as vehicle maintenance and use. Across all industries, vehicle-related incidents were the leading cause of fatalities in 2019/20.

Focus on the agriculture and utilities sectors

In 2019/20, 'Agriculture' and 'Arts and Recreation Services' had the highest number of fatalities (25 each from October 2019-September 2020), although the Recreation figure is skewed by the deaths arising from the Whakaari/White Island eruption. When converted to a rate of per 100,000 full-time equivalent workers, the 'Electricity, Gas, Water and Waste' sector represents the highest rate of fatalities in the last year. With such statistics, we expect WorkSafe to focus on PCBUs in these sectors in 2021.

Increased number of investigations

WorkSafe has faced recent criticism because of the decline in the average number of investigations it is conducting per month. We suspect that the decline is linked to resourcing issues, which were heightened in 2020 under Alert Level 4, during which WorkSafe's inspectors were largely working from home. WorkSafe also diverted significant resources to focus on its investigation into the Whakaari eruption. With the investigation having now moved to the prosecution stage, and to counter criticisms regarding the number of investigations WorkSafe carries out, we anticipate an uptick in the number of investigations, particularly in those sectors in which it is focusing.

AVERAGE NUMBER OF WORKSAFE INVESTIGATIONS PER MONTH

2016	2017	2018	2019	2020
30	26	18	15	14

Continued decline in enforceable undertakings

2020 saw WorkSafe agree only five enforceable undertakings. In 2019, it agreed four. This contrasts with the 15 it agreed in 2018. We expect the reduced appetite of WorkSafe and PCBUs to enter into enforceable undertakings to continue. For PCBUs, despite detailed guidance from WorkSafe on the process and criteria, enforceable undertakings are time-consuming to prepare and negotiate. Once approved, they can also carry significant compliance costs. While the number and quality of applications for enforceable undertakings received by WorkSafe are not publicly available, we suspect that WorkSafe recognises the benefits associated with the publicity and deterrent effect attached to prosecuted PCBUs going through the Court system.

Strategic litigation

We didn't see WorkSafe bring strategic litigation in 2020 to clarify uncertain areas of the law or to highlight the scope of its enforcement powers.

Specific issues that we anticipate WorkSafe will look closely at in the next 12 to 18 months, if the appropriate circumstances arise, include

- the scope and meaning of "so far as is reasonably practicable", a term used throughout the Act; and
- the duties of upstream PCBUs such as manufacturers of equipment.

Commerce Commission: Ready to educate and enforce

The Commerce Commission has been firmly set in enforcement mode for a number of years. With substantive changes to some of the key legislation that the Commission administers due to come into force in 2021, we expect the continuation of an active regulator ready to educate and enforce.

In addition to the Commission's enduring priorities that include product safety, credit issues, cartel and anti-competitive conduct and mergers, and regulation of critical infrastructure industries like energy and telecommunications, we predict the Commission will be focused on five key areas in 2021.

Travel-related breaches

2020 saw a record level of travel-related complaints to the Commerce Commission, largely due to COVID-19. Of the 9,892 complaints received between July 2019 and 30 June 2020, 1,225 related to travel. The Commission uses complaints to help prioritise its work and identify the issues that are likely to impact consumers and markets the most. We anticipate that investigations and enforcement action in this area will follow. Travel complaints covered themes such as: difficulty obtaining refunds; offers of credits rather than refunds; and new contract terms inserted in contracts providing for cancellation fees to be charged.

Environmental claims

Consumers are increasingly considering the environment when making purchasing decisions with many prepared to pay a premium for products that are environmentally friendly. In recognition of this, we saw the Commission release guidelines in July 2020 to help businesses understand their obligations when making environmental claims. With these Guidelines now in place, we expect prosecutions in relation to "Green Marketing" claims to follow in 2021.

Pricing representations

As expected, pricing representations have received ongoing scrutiny from the Commerce Commission in the past couple of years, with enforcement action pursued against a number of entities in 2019 and 2020 where pricing claims have been false or misleading. The Commission's November 2020 media release alerting consumers to misleading bargains on offer highlights the Commission's concerns. We expect the Commission to be active in this area in the year ahead with enforcement action set to continue.

Supporting economic recovery

The Commission has acknowledged that as the effects of COVID-19 bring uncertainty to markets, aspects of its work will be particularly significant in helping to safeguard the integrity of competitive markets. The Commission has confirmed that it will do this by educating industry about their competition law obligations and taking action against businesses that unlawfully reduce or remove competition.

Enforcing limits on the fees and interest that can be charged on high-cost consumer credit contracts

On 1 June 2020, restrictions on high-cost lending under the Credit Contracts and Consumer Finance Act (CCCFA) came into force. The restrictions include caps on the interest and fees that can be charged on high-cost loans and restrictions on making high-cost loans to certain repeat borrowers. The Commission has developed guidance to explain the changes and is poised to follow with enforcement action against those who breach the new provisions.

The Commerce Commission looks set to focus on five key areas in 2021.

Cartel conduct:

The introduction of criminal sanctions

The prospect of a criminal conviction and jail time for cartel participants from 8 April 2021, means that education about cartel conduct in New Zealand has never been more important.

From 8 April 2021, criminal sanctions for cartel conduct will come into force. The new criminal regime will operate in parallel with the current civil regime. The maximum fines will be the same as the civil penalties, but the criminal offence must be proven to the higher criminal standard of proof – beyond reasonable doubt – and will require proof of intent. Inadvertent behaviour will not give rise to criminal liability but may still breach the civil prohibitions.

An individual convicted for intentionally engaging in cartel conduct in breach of the Commerce Act 1986 will face a penalty of imprisonment for up to seven years or a criminal fine of up to NZD500,000 or both. Companies cannot indemnify individuals for penalties or reimburse their legal costs if they are found to have breached the cartel prohibition and a penalty is ordered.

What can we expect?

The Commerce Commission's focus areas for 2020/21 include educating businesses about cartels and its campaign to increase awareness of the cartel prohibitions ahead of criminalisation began in earnest in late 2020. We expect that the Commission will have a strong appetite to bring a criminal prosecution as soon as an appropriate case emerges.

Cartel conduct has been criminalised in Australia for more than 10 years, and New Zealand corporations can gather insights from Australia's experience to date:

- The Australian Competition and Consumer Commission's (ACCC) approach to investigations has changed following criminalisation: search warrants are now regularly used to gather evidence, when previously search warrants were rare. We expect the Commission will make similar changes to its approach to cartel investigations.
- It took seven years after criminalisation for the first criminal prosecution of cartel conduct in Australia. The ACCC focused first on the "low hanging fruit" – the first prosecution related to cartel conduct which was part of worldwide investigations and prosecutions. The Commission has been very vocal about its desire for criminalisation and prosecution. Decision-making in New Zealand is very different to Australia. We therefore do not expect there to be the same delays in New Zealand – the Commission will bring a prosecution as soon as an appropriate case emerges, regardless of its origins.

We expect that the criminal process will create different opportunities and challenges for potential defendants. Strategic decisions on how to respond to an investigation, and whether to encourage employees to seek independent legal advice, will need to be made much earlier. Given the potential for employees to be exposed to prison time, companies must also consider employment law implications when making decisions and gathering information about an employee's conduct. In particular, companies need to be careful to avoid inadvertently making admissions that may expose that employee to liability.

How to prepare?

Businesses should urgently prepare for the changes by:

- Ensuring that all employees and directors are aware of their obligations under the Commerce Act, especially around cartel conduct. A whole organisation approach is important because cartel conduct can often involve relatively junior employees.
- Putting in place formal compliance policies and frameworks, of which ongoing training is an essential element. A culture of compliance will reduce the risk of breaching the law and potential liability if a breach occurs.
- Preparing for how to react to any suspicions of misconduct or approaches from the Commission including what expert assistance to call on. The criminal regime creates a different environment for decision-making and strategy needs to be carefully considered early on.

IT disputes and COVID-19:

Act in haste and repent at leisure?

In March 2020, many New Zealand businesses were less than fully-prepared to provide IT support to their workforce at short notice to enable them to work 'remotely' during the lockdown.

Who led your company's digital transformation?

(a) The CEO

(b) The CIO

(c) COVID-19

Business continuity plans did not generally foresee that most or all staff, in all locations, would be working remotely at the same time for some months.

Transactions and systems were implemented quickly without the safeguards provided by normal procurement processes.

How organisations responded

Many business and other organisations, public and private, found that they did not have sufficient software licences for the number of people who needed to work remotely when lockdown started. Many staff found themselves locked out of their systems because the maximum number of logins was exceeded. As organisations scrambled to deal with this, thousands of staff were temporarily allocated time slots in which they could go online through their VPNs and do their work.

Organisations found that their top priority was to arrange additional software licences as soon as possible, with the senior executive team prioritising speed of execution above all else. They had to act quickly to be able to work in a locked down environment, including rapidly scaling their online working capabilities, deploying more licences and in some cases setting up whole new online web-based stores or environments to replace physical environments. Given the urgency and the workload, there was little appetite or need among providers to negotiate terms.

Decisions were made and actions taken with the best intentions, but with speed of execution being the top priority, sometimes little to no regard was given to contractual terms, cyber security protections, or privacy and other regulatory implications. Transactions were recorded in email exchanges or telephone calls and supplier terms were accepted without question.

The consequences

With business largely returned to normal, albeit with many staff still working remotely some or all of the time, organisations need no longer act in haste. There is now an opportunity to reflect on the position they find themselves in and consider whether they may need to repent at their leisure and remedy problems before they become worse.

We consider some typical scenarios, the risks that may result and mitigation strategies that may assist.

Did your organisation allow staff to download new software to enable remote working, or deploy it at speed without proper due diligence on the suppliers or their terms?

Some organisations allowed staff to accept suppliers' terms and conditions without challenge or even review, or accept 'click wrap' online terms, or simply download and use software which constituted acceptance of linked terms and conditions.

Many supplier terms are one-sided or onerous, with substantial minimum terms and fees. Many are also inadequate in terms of regulatory compliance and data protection.

Did your organisation deploy or use additional licences without using a contractual process?

Some organisations will have found that this placed them in breach of their supplier's terms and that onerous breach penalties applied. Others found that it moved them to a different pricing structure.

Many licences have minimum terms and fixed fees, even though the need for additional licences was only temporary. Acquiring further licences may also increase support and maintenance costs.

Did your organisation maintain cyber safety standards when additional staff began remote working for the first time?

Remote working comes with risks. Users must be vigilant with their use of passwords and two-factor authentication systems. There have been reports of online scammers persuading poorly trained staff who were unfamiliar with remote working to allow them to access systems.

Some organisations relaxed requirements for regular password changes and other security requirements such as payment authorisation systems when these were found to create difficulties for staff working remotely. This created opportunities for hackers and fraudsters.

Some organisations hurriedly built jury-rigged solutions to enable them to function at a minimum level. A Minimum Viable Product or hastily thrown together website solution may enable an organisation to continue in operation, but it should be checked carefully as soon as possible. A cyber-attack can have significant financial and negative public relations consequences.

Did your organisation begin to use, or increase its use of, cloud or "as a service" licensing arrangements or costs as it scaled up its capacity?

If so, was the correct contractual process followed? Did this move the organisation into a higher cost bracket with a commitment to pay for services that it no longer needs?

Some organisations will have found themselves bound to a prescribed minimum service period and high fees.

Is your business primarily a 'bricks and mortar' business that hurriedly went online?

Did you consider whether any regulatory rules applied to your new way of working? For example, alcohol suppliers that moved to an online business model must comply with different rules for the sale of liquor.

If you began collecting and processing customer records, have you complied with the Privacy Act and rules relating to data retention and protection?

If you set up an online payment portal, where you may collect and store credit card details, have you considered the implications of any payment rules and regulations?

If you set up a website, did you check it for vulnerabilities? Cyber criminals were also at home under lockdown, honing their skills. Cyber breaches are reported to have increased substantially during and after the lockdown.

If you are a director of any companies that might have done any of these things, have you asked the right questions of your management team, CIO/CTO?

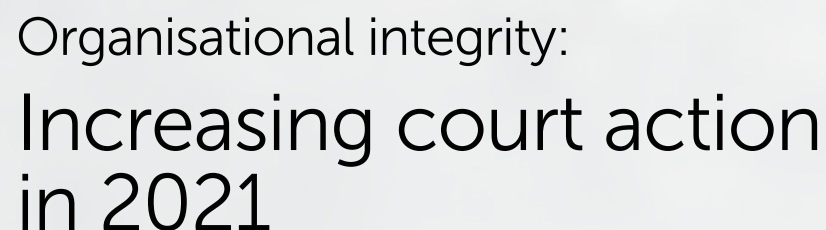
Directors and senior management should consider whether their organisations may have breached any contractual terms and incurred penalties, incurred onerous long term obligations, given undertakings regarding the use of their data, otherwise accepted unfair or unreasonable terms, increased their cyber risk or exposed their organisation to a technical vulnerability.

If issues are identified, directors and senior management should consider the potential consequences and look to mitigate these risks as soon as possible.

What can be done now?

Mitigation steps could include any or all of the following:

- Consider whether you should notify the counterparty, a regulator and/or your insurers if you have breached an agreement or any regulations.
- Consider whether there is a way to cure your breach or reduce the counterparty's loss. Are there any limitation or liability clauses that may assist?
- Consider whether you can remedy or cease any breaches of regulations or laws.
- Review any new terms and conditions and seek to engage the supplier to vary any unreasonable or unfair terms. This could be hard to achieve but it is better to try now than later.
- If you have moved to a new pricing tier due to your increased licensing or capacity needs, but no longer need them, can you engage with your supplier to drop back down? It might also be timely to try and agree terms and costs if you need to scale up again rapidly.
- Engage an expert to test your website or your new technical solutions for vulnerabilities and fix any issues.
- If a counterparty or a regulator is uncooperative, engage specialist legal or procurement assistance.



Organisational integrity:

Increasing court action in 2021

One of the litigation trends over the past 10 years or so has been an increased focus by government agencies on corporate misconduct. We see this trend continuing and expanding beyond government court action into private prosecutions and civil actions, as the broader public becomes more concerned about matters of integrity than ever before.

Since the establishment of the Serious Fraud Office (SFO) 30 years ago, progressive New Zealand governments have increased the regulatory and criminal response to corporate misconduct. Insider trading has been criminalised, new anti-money laundering and terrorist financing laws implemented, and the Financial Markets Authority (FMA) and other regulators have seen a significant increase in enforcement obligations and budgets. Most recently, New Zealand's privacy law has been updated to bring it into line with international norms, and cartel misconduct has now been criminalised, with new offences and potential for criminal convictions and imprisonment taking effect in 2021.

The trend underlying all of this is an increased public awareness of organisational integrity. Beyond a mere focus on financial misconduct, the public now expects corporations to behave more ethically across the board, and for the government to regulate and police such behaviour more comprehensively. The #metoo movement has been focused strongly on society's changing expectations around how women are treated, particularly in the corporate environment, with numerous high-level executives, and their organisations, coming under close scrutiny for sexual harassment and discrimination in the workplace. Consumers are increasingly concerned about ethical conduct by organisations also, including in respect of modern slavery and ethical supply chain matters, and corporations' responses to the challenges we face regarding climate change. Investors are also increasingly concerned to ensure that the corporations they support engage in ethical investments and behaviours.

The increasing public and regulatory pressures on organisational integrity mean that directors and managers need to ensure that their organisations are operating with integrity, and are prepared for litigation and public scrutiny should they not.

Expect increased Government/regulatory activity

The trend of increased investigation and enforcement of corporate misconduct by governmental regulatory agencies is set to continue. The SFO, Police, FMA, Department of Internal Affairs (DIA), Reserve Bank, NZ Customs, Commerce Commission and the Ministry of Business Innovation and Employment (MBIE) are just some of the government agencies tasked and resourced to investigate and undertake enforcement action where corporations are acting unethically and in breach of the law. The public expects this conduct to be policed, and it is a political imperative that this increased scrutiny by the regulators continues.

Not all Court action will be by the Government

2020 saw the first private claim in the High Court against corporations in relation to the environment, and in particular, their alleged contribution to the effects of climate change. This private action will not be the last we see in the climate change space, nor in other areas of organisational integrity. Expect to see Non-Governmental Organisations (NGOs) and private citizens take legal action against corporations, and potentially high-profile executives, in respect of a range of corporate misconduct, including ethical supply chain/modern slavery matters, and to see investor groups taking action around alleged unethical investments particularly where they are not fully disclosed.

"Organisational integrity" will become a more significant aspect of corporate due diligence

It has been common place offshore for some time to undertake a more comprehensive review of a target assets' risk profile than has been the common approach in New Zealand. In our view, this should become best practice, particularly when a transaction involves parties with connections into the United States, United Kingdom and continental Europe. Particular areas of focus are:

- International trade and financial sanctions
- Anti-bribery and corruption
- Anti-money laundering and countering the financing of terrorism
- Human rights, including modern slavery and supply chain integrity
- Competition law, including cartels and fair trading
- Environmental impacts and mitigation
- Privacy and data protection

Simply put, the best way to avoid the damage associated with a scandal is to avoid it in the first place. Corporations that take genuine steps to identify risk before acquiring assets will be well-positioned to avoid scandal and litigation, and to present a strong position to counter any suggestion of intentional malfeasance in litigation (particularly regulatory or criminal prosecutions) by doing so.

> Everyone loves a scandal, unless you are involved in one.

Demonstrating a genuine culture of compliance and ethical behaviour will be a differentiating factor in the market

Complacency, or even worse, ignorance, regarding risks in your existing business operations, is also a major risk factor for potential scandal. Alongside more comprehensive due diligence, a review of existing operations to identify and combat organisational integrity risks will be a critical step for management and boards in 2021 and beyond.

As with meaningful due diligence practices, a proper risk assessment of your existing business can help avoid the risk of integrity breaches and scandals. In the event an organisation is caught up in litigation nonetheless, position the organisation so as to avoid the aggravating effects of being found to have a 'cowboy culture', which was simply asking for such a scandal to occur.

In our experience, organisations that implement both an internal risk management function and utilise external support to review and advise objectively on their organisational integrity risks, position themselves best to avoid scandal and the consequent damage. Utilisation of external legal advice in particular, which can be done under the protection of legal privilege, enables organisations to obtain an honest and objective assessment of their risk management practices and potential legal liability. It also enables organisations to identify areas of improvement to ensure that risk management isn't stagnant. This will put the organisation in the best position to identify potential litigation triggers early, and where they cannot be avoided, enables you to work with your legal team from an early stage to develop and implement the best litigation strategy.

Everyone loves a scandal, unless you are involved in one. Increasingly, it is also the case that regulators, and other watchdogs, like to make examples of organisations that do not act ethically. Litigation in this space is likely to increase, and we encourage all managers and directors to think carefully about organisational integrity risk, and to discuss early how you can best manage it, and be prepared for litigation should it occur.

Our litigation and dispute resolution team

Our national dispute resolution team has an outstanding track record for resolving the most challenging disputes, and providing clients with practical advice on the law and litigation strategies that enhance their prospects of success.

They know the industry, their advice is prompt, commercial and reliable, and their service is exceptional.

Chambers Asia-Pacific 2020

A large full-service team, we act on the most complex large-scale commercial and regulatory disputes in New Zealand. Our team leads the way in providing legal advice on a wide range of disputes in the commercial, insurance, insolvency, financial, consumer, regulatory, energy and environmental, public law and IT spaces, as well as in health and safety matters, litigation funding and class actions, and cross-border disputes.

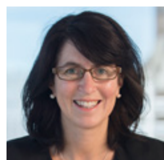
Ranked Band 1 by The Legal 500 Asia Pacific, we have some of the country's most experienced and proactive litigators.

Specialist areas of expertise we help with include commercial litigation, financial services, litigation, regulatory investigations, insurance, employment, insolvency and restructuring, consumer and competition, energy, environment and public law.

Our aim is to help our clients avoid disputes wherever possible, which is why our team offers commercially astute advice to resolve matters at an early stage and guide you through mediation and arbitration if that is the right option. We are also right at home at all levels of the court system including the High Court, Court of Appeal and Supreme Court.

Legal advice across borders and quick access to courts is no problem either, thanks to our international network through the MinterEllison Legal Group.

Who can help?



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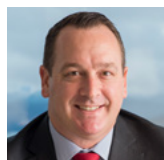

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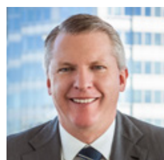

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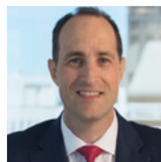

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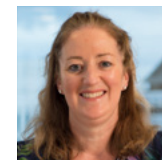

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