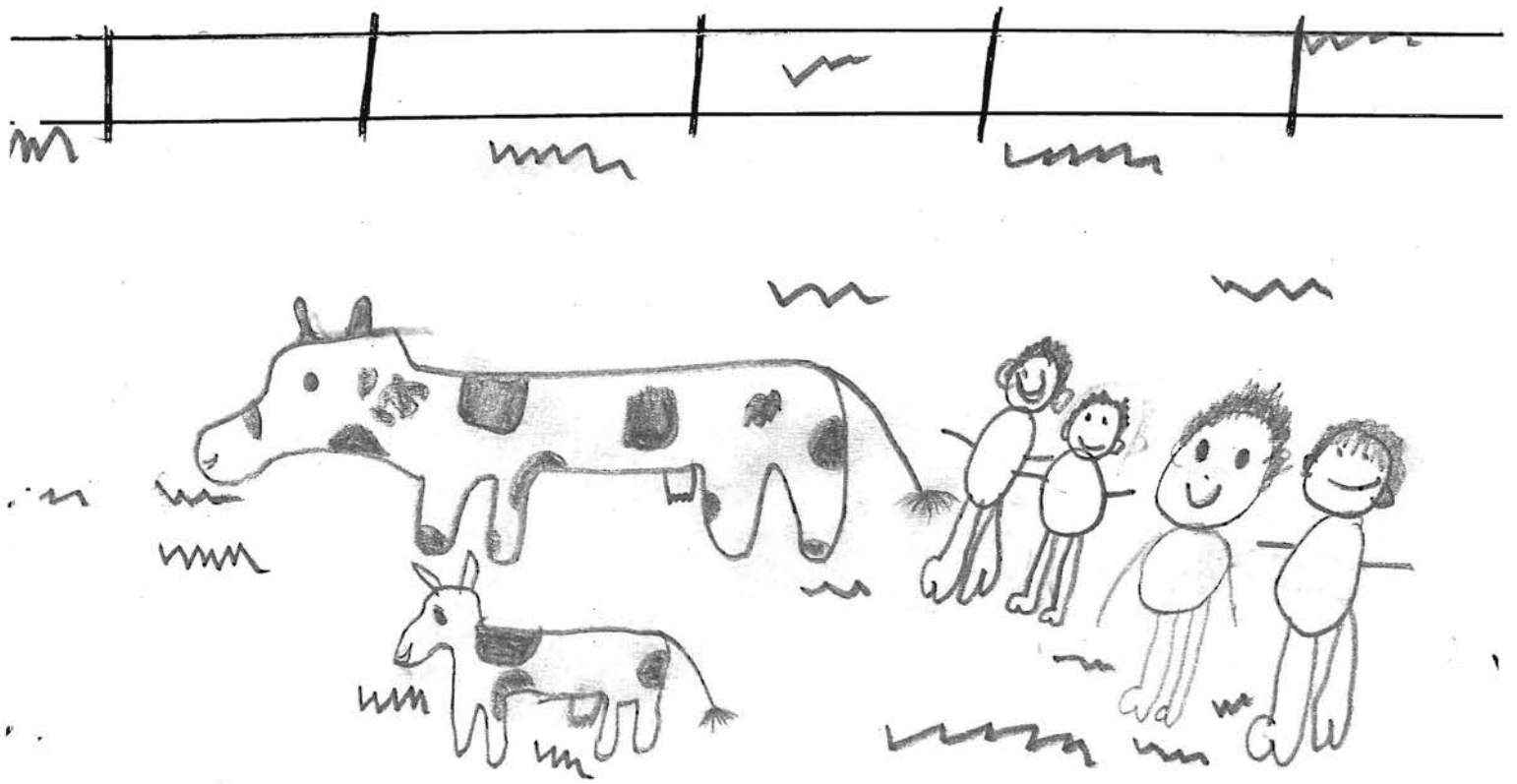


A word about...

Finance



Picture
by Kane

Titiroa Farms

A word about...

Finance

*Margaret Muller
2005 Primary Industry Council/ Kellogg
Rural Leadership Programme*

Executive Summary

The world of finance can be extremely confusing and complicated to the everyday person, especially when this is not a primary part of a person's business life. This introduction to finance lightly touches upon a few topics, very briefly. An effort has been made to distil out some basic facts that may be of interest to people who are not working in financial arenas frequently.

The report begins with an outline of some business structures for rural businesses. It progresses to look at two pieces of relatively recent legislation, which overhauls the law regarding financial contracts and security. These are the Credit Contracts and Consumer Finance Act 2003 and the Personal Properties Security Act 1999.

The report continues with a look at some of the aspects of loan documentation and the clauses contained in the fine print of these. A section covers guarantees and what they involve, followed by the initial stages of the mortgagee sale process.

The final section of the report looks at the role the Commerce Commission holds regarding financial matters, and some of the law it polices. The Banking Ombudsman Service, and the Financial Services Federation are also mentioned.

As life becomes increasingly more regulated it is vital that people keep abreast of changes in order to make more informed decisions and also to protect themselves from the possibility of being taken advantage of. Information technology is readily and cheaply available to all via the internet, enabling information to appear on computer screens and fall off printers. It is possible to keep up with new laws and regulations and agencies that can assist, if you know where to look.

Contents

Page 3	Executive Summary
Page 5	Contents
Page 7	Introduction
Page 9	Business structures
Page 11	Credit Contracts & Consumer Finance Act 2003
Page 13	Personal Properties Security Act 1999
Page 15	Loan Documentation
Page 17	Guarantees
Page 19	Mortgagee Sales
Page 21	The Commerce Commission
Page 23	The Banking Ombudsman
Page 25	Financial Services Federation
Page 27	References

A word about finance...

Introduction

The law generally seeks to give a high level of protection to persons in an everyday personal, domestic or household situation. When your life and livelihood is derived from the land, then you are afforded less legal protection. Farming businesses are classified as commercial and in many respects treated this way.

It is hoped that the information contained in this booklet will serve as an introduction to finance as it relates to rural businesses, and some of the law governing this area. It is intended to give a brief analysis of each topic with anticipation that it will provide an incentive for further inquiry.

Firstly, a word about...

Business Structures¹

As a business farming can operate under a number of structures:

- Sole trader
- Partnership
- Company
- Trust.

Sole Trader

A business owned and operated by one person. The assets and the debts of the business are the sole responsibility of the sole trader. He is personally liable for all obligations of the business. Financially the trader has 'unlimited liability'. In this situation, creditors can call upon any personal assets to meet business debt.

Partnership

Similar to the sole trader situation. Here two or more people form and operate a business. Normally the partners are personally responsible for the business liabilities. They are also exposed to unlimited liability.

Company

In law a company is an entity with legal rights and responsibilities of its own. A company can be formed with a minimum of one person. With small companies, the shareholders (the people providing the financial base), directors (governors), and the managers (hands-on operators), can be the same people. A company structure carries 'limited liability'. This means the company debt is limited. However, where directors have signed personal guarantees for company debt, the company and the directors as individuals can be pursued for debt.

Trust

The assets of a trust belong to the trust for the benefit of named beneficiaries. The business responsibilities and debt fall upon the trustees personally. A trust itself cannot be held liable. The trustees will be.

¹ Background reference source: Parry, Black, Bennett, Fundamentals of Finance

a word about...

The Credit Contracts and Consumer Finance Act 2003²

This Act takes over from the Credit Contracts Act 1981 and the Hire Purchase Act 1971. These Acts no longer exist. From a legal point of view there is no more hire purchase, but in practical terms purchases continue to be made, with payment spread forward over time, but now known as 'financing'. For example; the Warehouse brochures now invite 'get it on finance', where they formerly said 'get it on hp'. Purchasers are not likely to have noticed a change.

This Act is designed to fit together with another Act; the Personal Properties Securities Act 1999. Together the two Acts create a framework which positively and easily identifies true ownership of an article and whether there is money owing on it.

As the title of the Act suggests there are two distinct areas covered. The first relates to 'credit'. The second relates to 'consumer' situations. A 'consumer' for the purposes of the Act is a person who is not acting in a business or commercial capacity, but in a 'personal, domestic or household' capacity. Although there will be times when the line will be blurred the Act gives guidance to work this out.

A 'credit contract' is a situation where one person agrees to allow another to owe a debt on a purchase.³ It does not matter whether interest will be charged or not for the credit. Most banking services, mortgages, personal loans and purchases made formerly under hire purchase arrangements are credit contracts.

From a farming business perspective, the sections of the Act regarding 'credit' are the most applicable. It is this part of the Act involving financial transactions which are most relevant. So, whether buying a tractor or a farm, the transaction will be regulated under this Act. In a situation where a purchase would normally be considered a 'consumer' purchase, such as buying a family car, by getting the purchaser to acknowledge in writing that the vehicle is to be used primarily as a business vehicle, the consumer protection will not apply.⁴

Transactions which are not 'credit contracts', include:⁵

- Purchases paid within two months;
- Unauthorised overdrafts;
- Where the purchaser is a trustee of a family trust.

Much of the Act pertains to 'consumer' dealings. These include:

- Product purchases;

² Background reference sources: [NZLS Credit Contracts & Consumer Finance Act 2003](#); Commerce Commission [A general guide for the credit industry](#)

³ Section 6 & section 7

⁴ section 14

⁵ section 15

- Leases, which are defined as contracts for the hire of goods;
- Buyback transactions where the person selling their home continues to live there, with a right to repurchase.

'Disclosure' is the term used to describe written statements the creditor (seller) must issue to the debtor (buyer). The Act outlines these requirements in detail.

For more information/advice:

Contact your local Citizen's Advice Bureau listed in the phone book or
The Commerce Commission at www.comcom.govt.nz
or e-mail contact@comcom.govt.nz

Auckland ph (09) 920 3480
Fax (09) 920 3481

Wellington ph (04) 924 3600
Fax (04) 924 3700

Christchurch ph (03) 964 3450
Fax (03) 964 3451

a word about...

The Personal Properties Security Act 1999⁶

This Act could be called the 'Buyer Beware Act'.

'Personal property' is property which is not land.

A 'security interest' is a claim, which can be applied to personal property which has been purchased on credit, or used as collateral for a loan.

The purpose of the Act is explained in the Long Title;

... to reform the law relating to security interests in personal property and in particular...

- (a) To provide for the creation and enforceability of security interests in personal property; and*
- (b) To provide for the determination of priority between security interests in the same personal property; and*
- (c) To provide for the determination of priority between security interests and other types of interests in the same personal property; and*
- (d) To provide for the enforcement of security interests in personal property other than consumer goods; and*
- (d) To provide for the establishment of a register of security interests in personal property.*

So in simple language, one purpose of the Personal Properties Securities Act 1999 (PPSA) is the creation of a system for the recording of property which has some sort of financial encumbrance the Act creates a registration system. Registrations then act as notice to anyone who may wish to buy, or lend against the article. The PPSA applies to 'non-consumer goods', which are those not predominantly for 'personal, domestic or household' use.

The Act supersedes the former Chattels Transfer Act 1924, the Motor Vehicles Securities Act 1989 and Part IV of the Companies Act 1993. The PPSA came into force 1st May, 2002.

'Security Interest'

Section 18 of the Act defines 'security interest' as:

- (a) ... an interest in personal property created for by transaction that secures payment or performance of an obligation without regard to:*
 - (i) the form of the transaction; and*
 - (ii) the identity of the person who has title to the collateral;*

So, where an article has some sort of debt attached, directly or indirectly, there is a mechanism, available to anyone with good reason, who wants to enquire.

⁶ Background reference source: Business Law & Practice in NZ

For example; Farmer X wishes to sell his Massey Ferguson tractor. He advertises it for sale in the local provincial newspaper. Farmer Y sees the ad, and after viewing the tractor, is interested in buying it. Farmer Y is able to search the electronic register to see if the tractor is free of 'security interests' before proceeding with a purchase.⁷

The PPSA register is electronic and accessible at any time. The information held includes:⁸

- the debtor's name and address. If this is an individual, his or her date of birth. If an organisation, its name and authorised person.
- for companies, the company number.
- the name and address of the secured party (that is the person who is to hold a security interest) if an organisation, the name and address of the authorised person.
- the collateral described with serial number.
- the date of former registration under the former law.

The government website for the Personal Properties Security Act, and the register can be located at: www.ppsr.govt.nz. Searching the register can be done for a small charge.

The Credit Contracts & Consumer Finance Act, together with the Personal Properties Securities Act form a package, which aims to protect sellers, lenders, and unsuspecting future buyers from becoming involved with property which is financially encumbered.

For further information:

The Commerce Commission. (contact details page 12)

⁷ section 173 (c)(i)

⁸ section

a word about...

Loan Documentation⁹

The paperwork involving taking a loan is likely to be cumbersome and in a “foreign” language. The process may also be just one strand in a series of transactions or movements. For instance, moving sharemilking positions or changing farms will entail a number of components. They may include buying or selling stock, or land, packing up and moving households, families, stock, machinery and equipment. Banking, insurances, utilities, changing schools and so on, all add up to a huge logistical exercise. A tremendous amount can be happening in what can be a short period of time.

Legal requirements can seem a formality, with an expectation that ‘the lawyer’ knows his job and will safeguard your interests. What do we understand of the explanation given of what the loan or mortgage documents mean? Here follows a brief overview of the main standard parts of a loan document.

Parties- the lender, the borrower, and maybe a guarantor.

Recitals- a summary to the background to the loan.

Interpretation- a set definition to words or phrases used in the documentation, to avoid differing interpretations.

Facility description- states the amounts of the loan and what it is for.

Conditions Precedent- Requirements the borrower must meet before the funds are released by the lender. They will include certain legal requirements such as that any relevant consents are in place, that the borrower has been honest and accurate with their application, and information of the Companies Act requiring Directors Resolutions recording that the transaction is in the company’s interest, and that the company is solvent.

Interest- Includes the rate and whether the rate is fixed or varied and what the interest payment periods are to be.

Repayment- Sets the duration of the loan. If there is a fixed term there will be a date given. Under a fixed term loan there can be the ability for the loan to continue at the request of the borrower and discretion of the lender. It is also possible for the loan to be repaid early, in part or whole, with a fee likely, set at a percentage of the interest chargeable, for instance, one month’s interest amount for the sum being repaid.

⁹ Background reference source: [NZLS Banking Law Update, Part 4](#)

Default Interest- An increased interest rate charge for a failure (default) to keep to the conditions of the loan agreement. Often this is likely to be for a late payment or non-payment of a due payment.

Fees- A charge for the initial setting up of a loan, usually set at a percentage of the amount borrowed.

Undertakings -The clauses in fine print! Some of the main ones relate to financial requirements to provide financial statements, accounts, budgets and perhaps business plans. If the borrower is a company a Director's Certificate verifying the reports will be required, so that responsibility can be tagged to a real person. There will be an obligation to keep the loan property and other business assets used as security, adequately insured. If the property requires consents from local authorities, these must be kept current. The funds loaned must be used for the purpose which has been approved by the lender. Taxes must be paid. In other words, all aspects which could affect the value of the debt owed, must be protected to safeguard the lender's investment .

Warranties - Similar to undertakings. Relate to the status of the borrower at the time of entering the loan contract, to assure the lender that the borrower's situation has not altered.

Defaults - These will usually be for failure to pay a payment. Defaults can also be for breaches of clauses in the 'undertakings' section, for example a breach of 'Fundamental terms' where requirements have not been met, such as a failure to maintain insurances.

Depending on what the 'default' is, and how vital a part of the loan contract, a lender does have the power to call a loan in, that is, demand his money back.

For further information:

Banks and financial institutions will usually have their own individual loan documentation. A request could be put to view this to the institution/s involved, as there will be differences that will make a difference to the value and fine detail of a loan.

The local Community Law Centre. (a free service)

a word about...

Guarantees¹⁰

When speaking of finance, a 'guarantee' is a promise made by a third person, to a lender, to ensure that a borrower meets his obligations to the lender. This means that if a borrower does not maintain his payments, for example, then the 'guarantor' can be called upon by the lender, to pay. In effect the lender is getting two for the price of one. The borrower and the guarantor are both liable for the same debt.

Guarantees can be used in situations where the borrower is a minor, because a contract with a minor cannot be legally enforced. A young farmworker purchasing a farmbike as a requirement for employment is an example. Here, parents or employer are likely to be asked to act as a guarantor, before a dealer will agree to finance a sale.

Company debt is usually limited in New Zealand so it is not unusual for the directors to give a 'personal guarantee' to banks or financiers for major borrowing, such as mortgage finance. This enables a lender to take any or all other property a director owns, now or future acquired, to make up any shortfall upon repayment of the company debt. The reality is, for small companies, there is a 'Hobson's choice'. If finance is required, the 'personal guarantee' will be required to be given. This can mean that the combined value of the mortgage security, together with other personal property, can be many times the value of the borrowing. As a lender is really only interested in what is owed to them only, the more asset available to be cashed up, the easier it is for them to 'pull the plug'.

Depending on the way a guarantee document is worded, it is possible for a lender to take recovery action against a guarantor, without taking action against the borrower.¹¹ This makes Guarantees very powerful contracts. Once signed, there is virtually no way of getting out of the Guarantee without first repaying the debt.¹²

¹⁰ Background reference source: NZLS Banking Law Update:
Business Law & Practice in NZ

¹¹ NZLS Banking Law Update, page 32

¹² *ibid* page 34

a word about...

Mortgagee Sales¹⁵

When a borrower, a mortgagor, fails to abide by the terms of the mortgage contract, the lender, the mortgagee, has the right to act in order to rectify the situation of default. The mortgagee is able to demand full repayment of what is owed, and has the right to sell the mortgaged property, if repayment is not made. Usually the default will be because interest or principal repayments have not been made by the borrower.

'Mortgage' is a legal term for a debt that has been registered under the Land Transfer Act 1952, on the Title of the land, for a financial value that has been loaned against. The land forms the collateral or security for the financial debt. This registration acts as notice to anyone who looks at the legal particulars regarding a section of land, and is known as 'searching'. Searching can be done through Land Information Offices. Mortgaged land cannot be transferred legally without the knowledge and approval of the mortgagee.

The legislation dealing with mortgages is the Property Law Act 1952 and the Land Transfer Act 1952. These two Acts go hand in hand and are both needed when making legal transactions involving land, such as leasing or selling.

There are very specific procedures that must be followed for a mortgagee sale. A borrower in default has the ability to repay the debt owing at any time before a sale is organised by the lender.

The Property Law Act 1952 (PLA) sets out the procedure to be followed by a lender to force repayment of a mortgage debt. There are set forms, which must be used: specific ways of notification, and specific time periods to allow opportunity for the default to be corrected, or satisfied.

The first step is notifying the borrower, in writing, of a **demand**, stating that there is a default, and that the lender requires repayment of the mortgage debt owed. Section 92 PLA states that a lender must issue the borrower with a notice stating the default, and allowing four weeks (28 days) for the situation to be rectified.

Although it is legally acceptable for the notice to be sent by registered mail it is more usual to be delivered in person. This is likely to be done by a '**process server**', a person who hand-delivers documents to the person named in the document. This delivery is called '**servicing**'. The process server must ascertain, before handing the notice to the borrower, that he or she is the person named in the notice. A notice must be handed to each individual borrower. Where there is more than one mortgagor, the four-week notification period does not begin until the last individual mortgagor (borrower) has been served. The greater the number of mortgagors, the greater

¹⁵ Background reference material: [NZLS Mortgagee Sales Update](#)

possibility of a protracted notification period, from the serving of the first mortgagor, to the last.

A process server cannot legally serve notices on a Sunday or Public Holiday days, and should observe daylight hours.

Anyone confronted with a situation described above is strongly urged, with haste, to employ the services of a solicitor, if this is not already the case. The situation requires professional assistance. This does not mean, however, that it is to be expected that the lawyer can or should manage the complete situation.

For further information:

Books and articles about this subject can be sourced from Law Libraries, which are attached to the Faculty of Law, at New Zealand universities. These libraries are open to the public.

a word about...

The Commerce Commission

The Commerce Commission is the ‘watch dog’ of commerce. It guards the integrity of ‘trade dealings’.

It is ‘...an independent Crown entity... established under section 8 of the Commerce Act 1986. Its’ role is to enforce legislation and regulations under its control.’¹⁴

The Commission not only investigates and brings prosecutions for large commercial situations, but also for individual situations. The topics looked at, such as the PPSA, CCCF, banking and financial services, are all overseen by the Commerce Commission. So, if someone has had a bad experience with financial dealings with ‘Shark Finance Co.’, and finds the internal complaints procedure unsatisfactory, the Commerce Commission may be able to help. Of real benefit to individuals who make an approach to the Commission, is that this can be made directly, without the need to use professional assistance, such as a lawyer. If the Commission finds that there is a case to be answered, it will undertake this, even to the extent of bringing court proceedings.

Other legislation the Commission is responsible for enforcing, and which can involve **finance**, is the **Fair Trading Act 1986** and the **Consumers Guarantees Act 1993**. These two Acts are not to be overlooked as they can be relevant in many rural business situations.

The **Fair Trading Act** often features in cases on ‘Fair Go’. These often involve car salespersons, real estate deals, tradespeople, and their services. The applicable section of the Act is Section 9;

Misleading and deceptive conduct generally- no person shall, in trade, engage in conduct that is misleading or deceptive or is likely to mislead or deceive.

So if a ‘Shark Real Estate Co.’ salesperson knowingly overstates the returns of a property, you purchase relying on that information, then find the information was exaggerated, there is redress through the Act and the Commerce Commission.¹⁵

The **Consumers Guarantees Act 1993** undertakes to ensure that when you buy a product or service that you are getting what you are paying for. The Act goes beyond the sale of goods to include services. It implies certain guarantees in contracts so issues which arise after purchase, and were not considered at that time, can be ‘read in’, at a later time, by a court, if necessary. Following is a list of some of what the Act contains:

- Section 2** ‘goods’ are physical property, excluding land.
- Section 7** acceptable quality.
- Section 8** fitness for particular purpose.

¹⁴ Overview, para. 1

¹⁵ Coxon, Coxon v Leipst C.A. 1999

- Section 11** price to be reasonable, if not stated.
Section 18 remedies, where a supplier will not, such as rejection, compensation, or contract cancellation.
Section 21 substantially unfit.
Section 23 refund or replacement option.
Section 28 services require reasonable care and skill.

Part V, section 41 applies to trade situations only

The Commerce Commission contact details:

Contact Centre
Commerce Commission
PO Box 2351
Wellington

Freephone 0800 94 3600
e-mail contact@comcom.govt.nz
website www.comcom.govt.nz

a word about...

The Banking Ombudsman Commission¹⁶

The Banking Ombudsman service is free and independent. It provides a means of self-regulation of the banking industry within the group of ten participating banks.¹⁷ The Code of Banking Practice sets the baseline standards for the Ombudsman to work from when processing complaints, which can be made about any banking service.

The Ombudsman will investigate, mediate and endeavour to negotiate a resolution between customer and bank. Failing a resolution, the Ombudsman has the power to make a decision, and award compensation. This decision is binding on the bank concerned, but not on the customer, thus allowing for the customer to choose to litigate instead.

Compensation for losses up to \$120,000 for banking services, or up to \$150,000 for insurance products, can be made by the Ombudsman.

There is a set, but user-friendly procedure, which must be followed when making a complaint. Firstly, a complaint must be made directly to the bank concerned. If dissatisfied with the result of the bank's internal investigation, an approach can then be made to the Ombudsman. This can be done personally, or through a lawyer. An initial phone call to the Ombudsman Office will establish whether there is a situation which can be investigated. A complaint in writing will then be invited by the Ombudsman.

For further information:

Contact the Banking Ombudsman at:

PO Box 10-573
The terrace
Wellington

Freephone 0800 805-805
or (04) 471 0006
fax (04) 471 0548

e-mail help@bankombudsman.org.nz
website www.bankombudsman.org.nz

¹⁶ Background reference source: Case Note Compendium 2003-2004

¹⁷ April 2004 brochure. Banks include: ANZ, ASB, BNZ, Citibank NA, HSBC Ltd, Kiwibank, NB, Rabobank, Superbank, TSB, Westpac. (NB: ANZ & NB now combined)

a word about...

Financial Services Federation¹⁸

Not all banking and lending organisations are registered banks. Many are Building Societies and other financial institutions. For these financial services providers, the Financial Services Federation, an Incorporated Society, provides support for currently forty-seven members.¹⁹

The Federation also;²⁰

- Works in policy and legislative development
- Provides information for Government Departments.
- Liases with other finance/insurance providers.

The Federation has a mandatory Code of Conduct for members covering;²¹

- Confidentiality
- Fair, reasonable and honest conduct
- Privacy
- Disclosure of costs
- Comprehensible documentation
- Honest advertising
- Legal proceedings to be used fairly
- Community minded

Complaints²²

The Federation offers a complaints procedure to facilitate a resolution between Federation members and complainants. However, unlike the Banking Ombudsman Service, the Federation works completely within the member company's complaints procedure.

For further information:

The Financial Services Federation
PO Box 10-053
Wellington

Ph (04) 472 1731

Website: www.fsf.org.nz

¹⁸ Background reference source: Fed. Website; www.fsf.org.nz

¹⁹ www.fsf.org.nz/profile.html, page 1

²⁰ *ibid*, intro, page 1

²¹ *ibid*, Code of Conduct

²² *ibid*, intro, page 2

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