

BURROWES and Company

Barristers and Solicitors

Client Newsletter

May 2010

INSIDE THIS ISSUE:

<i>Restructuring: the Three D's</i>	1
<i>Franchise Agreements</i>	2
<i>Real Estate Agents Act 2008</i>	2
<i>Employment Update</i>	3
<i>Trust Beneficiaries' Right to Information</i>	4
<i>Mediation</i>	5
<i>Staff announcements</i>	6

RESTRUCTURING: THE THREE D'S

With the continuing effects of the economic downturn 'kicking in', interest rates on the increase, commentators predicting a flat property market, and expected changes in the upcoming budget, another wave of individuals may be contemplating downsizing, debt reduction or disposing. The purpose of this article is to highlight in a brief and general way some of the legal issues to be mindful of.

Downsizing

Downsizing for property investors usually involves the sale or transfer of a rental property or two. The following are some of the matters to consider:

- If the property is held by a company or trust then the sale needs to be in the best interests of the company or the beneficiaries of the trust.
- There may be depreciation recovered on the sale that is subject to tax.
- Valuations of the property may be required if the parties are not dealing at 'arms length', to avoid gifting issues.
- On the sale of shares in a company (rather than the sale of the asset itself), or amalgamation of one company into another, there are 'minimum continuity of shareholding' requirements to be considered to ensure tax losses and imputation credits are saved and not forfeited. There could be tax losses to be set off against taxable income before the sale of shares where that 'minimum continuity of shareholding' may be broken.

Debt Reduction

Debt reduction raises further issues that may need to be considered. The cost of breaking fixed interest rate repayments may be significant. The lender may not be prepared to accept repayment of a particular loan on a property sale and may require all sale funds to be repaid. The lender also may not cooperate in the release of a security such as partial discharges of land or the release of personal guarantees. New criteria may be imposed on the redraw of funds.

Dispositions

For commercial property dispositions there are a number of issues to consider. These may include:

- The GST status of the transaction and whether GST is payable or not.
- The 'associated persons' rules, affecting dealers and developers, that impact on tax gains that would otherwise escape the tax net.
- Commercial tenants may be looking to change premises not only to reduce costs but as a result of lease inducements, incentives (such as rent free periods) or lease surrender payments. This raises issues as to whether they are deductible expenses or not. The tax treatment for each party will depend on how the deal is structured and the tax profile of each party.

Often in fixing up one problem by a disposal you can create another. For example, the transfer of a leaky property to a trust or company. This amounts to a change of ownership. While this may have estate planning benefits for the transferor, it will prejudice any claim the trust has in regard to the leaky problem, as it will break the causative link against the territorial authority. Acquiring the property with knowledge of the leak may also amount to contributory negligence. If the transferor has already lodged a claim with the Weathertight Homes Tribunal this must be terminated.

With some projects put on hold due to the downturn it is important to check that resource consents are still valid. A resource consent will lapse on the date specified in the consent unless it is implemented or an application is made to the consent authority to extend the lapse period. In some instances, such as water and discharge consents, these will need to be transferred (for example, if you are disposing of a beach property). Sometimes restructuring may involve a change of building use (for example, disposing of flats to a company that operates serviced apartments) that may require notice of a change of use to the territorial authority.



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FRANCHISE AGREEMENTS

Franchising is a business model in which one business (the franchisor) allows a separately owned business (the franchisee) to use their systems, brand name and other intellectual property rights in return for royalties and other considerations. The advantage for a franchisee is that they get the benefit of a proven and tested business model. According to *Franchise Information New Zealand* around 80% of franchised businesses still operate after 5 years, compared with only 20% of independently started businesses. The franchisor, on the other hand, is able to expand their business without providing the capital and taking on risk.

The association between the parties is symbiotic. The franchisee relies on the franchisor and the other franchisees to maintain the reputation of the brand. The document that gives rise to the relationship is the franchise agreement which sets out the conditions upon which the franchise is to operate. The franchise agreement sets out the:

- fees to be paid, both upfront and ongoing,
- duration of the agreement and renewal rights,
- intended territory or market,
- dispute resolution procedure, and
- rules relating to the on-sale of the franchise.

In order to assist the franchisee and to ensure consistent quality of service amongst all franchisees there is usually a franchise manual that provides operational details. This manual contains the business model, with most agreements requiring strict adherence to it.

Fundamentally, franchise agreements should be approached like any other contract and need to clearly reflect the arrangement between the parties. Clauses that are unnecessary to the functioning of the relationship need to be carefully examined by an independent lawyer, preferably one with franchise experience. Many franchise agreements, particularly with large firms, are non-negotiable. Prospective franchisees should be prepared to not sign contracts that contain onerous and one-sided terms.

There are a number of common pitfalls within franchise agreements. For example, the franchisee needs an exclusive territory within which the franchisor may not grant any other franchise licenses. Clauses that allow reduction of this territory by the franchisor are common and should be considered carefully. Also, the franchisor should specify the steps they will take to protect the intellectual property rights being paid for. The exact method of calculating the royalties needs to be specified, as well as penalties for late payments. Clauses that allow for early termination are very common and need to be clearly understood. Agreements that limit the liability of the franchisor to the franchisee are cause for concern, particularly when related to obligations for marketing, training, and disclosure statements in the negotiation phase.

There is no specific franchise legislation to protect franchisees. However around half of franchisors abide by a self-regulating code of conduct that aims to “promote high standards of franchise conduct” and does offer some protection against unreasonable and unfair conduct on the part of the franchisor.

REAL ESTATE AGENTS ACT 2008

The Real Estate Agents Act 2008 came into force on 17 November 2009, replacing the 1976 Act and introducing a new regulatory regime. The Act’s purpose is to promote and protect consumers’ interests and “promote public confidence in the performance of real estate agency work”. Some of the important changes under the new Act are outlined below.

Real Estate Agents Authority

A Real Estate Agents Authority (“Authority”) has been established as an independent Crown entity to replace the Real Estate Agents Licensing Board. It will be responsible for such matters as licensing, receiving complaints, disciplinary action, regulating standards, and consumer information. The Associate Minister of Justice Nathan Guy has stated that the public will now be able to access the Authority to gain impartial and easy to understand information,

and that the Authority will provide a robust, transparent complaints and disciplinary process.

Each committee will have three members and will investigate complaints, make determinations about charges before the Real Estate Agents Disciplinary Tribunal, refer complaints to other agencies where appropriate, as well as inform complainants about decisions and publish decisions.

Real Estate Agents Disciplinary Tribunal

The Real Estate Agents Disciplinary Tribunal (the “Tribunal”) has been established, and is independent of the Real Estate Institute with members being appointed by the Minister.

Continued from page 2.

REAL ESTATE AGENTS ACT 2008

The Tribunal will hear and determine claims brought by a Complaints Assessment Committee and will hear any subsequent appeals against the Committee's decisions.

The hearings are to be held in public, and appeals of Tribunal decisions will be heard in the High Court. The Tribunal may:

- suspend or cancel a licence,
- impose a fine of up to \$15,000 in the case of an individual or up to \$30,000 in the case of a company,
- order agents to pay compensation of up to \$100,000 or have their licence cancelled or suspended.

Disclosure Obligations

Real Estate Agents are now required to provide certain information to clients such as disclosing conflicts of interest, and making disclosure of all discounts and rebates the agent will receive.

Agents must provide an approved guide to clients who are entering into agency agreements or agreements for sale and purchase. The guide will provide a plain language explanation of the document and the implications of signing it.

Agency Agreements

Clients must be given a copy of an agency agreement within 48 hours of signing. In the case of a sole agency agreement the client will now have a cooling-off period, until 5pm of the day following signing, to decide if they wish to cancel the agreement.

EMPLOYMENT UPDATE

The employment law landscape is an area of reform that the National Government has targeted since taking office. Listed below are some of the recent changes and proposals for change in employment law that may affect you.

Definition of Serious Harm

The Minister of Labour, Kate Wilkinson, announced in December 2009 that the Government proposed to amend the definition of serious harm under the Health and Safety in Employment Act 1992. The definition of serious harm is important as an employer or person in control of a workplace must, where serious harm has occurred, report this immediately to the appropriate authority - the Department of Labour, The Civil Aviation Authority or Maritime New Zealand.

The proposed definition of serious harm will contain three main categories of harm:

- Trauma injury – physical harm arising out of a single accident or event and defined by the degree of physical incapacity,
- Acute illness or injury – requiring treatment by a medical practitioner and caused by exposure to workplace hazards, and
- Chronic or serious occupational illness or injury - physical or mental harm requiring hospital admission, in-patient surgery, or able to be confirmed by a specialist medical diagnosis.

It is expected that the proposed definition will be clearer and easier to use and will remove the gaps in coverage of certain types of harm or hazard which currently exist.

Report on Workplace Deaths

In December 2009 the Government ordered a report into workplace deaths. At that time there had been 31 workplace deaths in 2009 - all of which were men.

Most of the deaths remain under investigation. The Department of Labour has been asked to identify whether there are any common underlying causes and whether employers had failed to meet their obligations to keep employees safe.

Holidays Act Review

The review of the Holidays Act 2003 was received by the Minister of Labour, Kate Wilkinson, in December 2009 and the Government intends that proposals for change will be introduced to a select committee for comment this year.

Some of the proposals may include:

- the opportunity to trade 1 week of annual leave for cash,
- a change in the method of calculating holiday and sick leave entitlements, and
- the transfer of public holidays to another day.

Watch this space for further updates!

Rest and Meal Breaks

Since 1 April 2009 employees have been entitled to compulsory rest and meal breaks after a certain number of hours of work. Many workplaces met or exceeded the compulsory minimums, however for some workplaces the compulsory prescription of rest

Continued on page 4.

EMPLOYMENT UPDATE

Continued from page 3.

and meal breaks presented difficulties and significantly affected their workplaces.

The Rest Breaks and Meal Breaks Amendment Bill, while maintaining an entitlement to rest and meal breaks, proposes that:

- employers and employees may agree on the timing of the breaks rather than the timing being prescribed by legislation,

- employers may not have to provide a complete break from work duties in situations where the employee is a sole attendant, and
- where a break cannot reasonably be provided the parties may agree that time off be given at an alternative time. For example an employee may start later or finish earlier in the day.

The Government hopes that this relaxation of the requirements will provide employers with the flexibility to schedule their rest and meal breaks in a way that best suits their industry.

TRUST BENEFICIARIES' RIGHTS TO INFORMATION

How much information should beneficiaries under a trust be given, and what information are they entitled to? In many trusts the settlors and trustees are Mum and Dad and the beneficiaries are the children. Usually the children are kept informed and advised of the assets in the trust and the question of what information should be disclosed to the beneficiaries is often not an issue.

Questions may arise as beneficiaries get older or where communication between trustees and beneficiaries is limited or has broken down. The beneficiaries may become suspicious of the actions of the trustees and demand financial statements and other financial information from the trustees.

Trustees are not legally required to show beneficiaries all Trust documents, although in many cases trustees will, for example, supply a copy of the Trust Deed, information and explanation as to investments, financial statements and accounts of the Trust.

Historically it was thought that a beneficiary under a fixed trust ("fixed beneficiary") had an entitlement to view trust documents and information, and a beneficiary under a discretionary trust ("discretionary beneficiary") did not. Under a fixed trust the number of beneficiaries and the share they will receive are defined. Under a discretionary trust the trustees may use their discretion as to who will be a beneficiary and what share a beneficiary will receive. The reasoning therefore was that a fixed beneficiary has an entitlement to Trust property, whereas a discretionary beneficiary merely has the right to be considered a beneficiary.

In *Schmidt v Rosewood Trust Ltd* the Privy Council held that a beneficiary's entitlement to seek disclosure of trust documents is based on the Courts' inherent jurisdiction to administer Trusts rather than whether the beneficiary is a fixed beneficiary or a

discretionary beneficiary. Both fixed and discretionary beneficiaries can apply to the Court for disclosure of Trust documentation.

Where a beneficiary applies to the Court for disclosure of a Trust's documents, the Courts will, in exercising their discretion, balance the interests of trustees, beneficiaries and third parties. The beneficiaries do not have an absolute right to information. The Court will consider the nature of the information and the interests of all the beneficiaries.

Information which the Courts have in the past provided to beneficiaries include:

- copies of the Trust Deed,
- financial accounts and statements of the Trust,
- any Deeds of Variation of Trust Deed, and Deeds of Retirement and Appointment of Trustees,
- valuations of assets of the Trust, and
- legal opinions related to beneficiaries rights and the interpretation of a Trust Deed's provisions.

In exercising their discretion, the Courts will consider such factors as issues of personal and commercial confidentiality and sensitivity, whether limitations need to be placed on the use of the documentation or information, whether some documents should be withheld in full or in part, and what impact the disclosure will have on the trustees, the beneficiaries or third parties.

There will no doubt be times when a trustee will refuse a beneficiary's request for trust information. This decision is more likely to be respected and accepted where the trustee and beneficiary have developed a history of communication and respect. As a trustee, if you are unsure as to what type of Trust information you need to disclose to the beneficiaries, we recommend you seek legal advice beforehand.

SNIPPETS

Court Ordered Mediation for Civil Disputes

The Government announced in November 2009 that it will carry out a pilot scheme in the High Court in Auckland that will see parties referred to court-ordered private mediation for civil disputes.

The pilot scheme will consist of 50, one-day mediations carried out by private mediators. A panel of between 12 and 15 mediators, who hold legal qualifications and current practicing certificates, will be established.

Currently mediations are carried out by Associate Judges. However the Government would rather see

Associate Judges spend time on cases that require judicial attention rather than mediating disputes.

A review of the scheme will take place after the pilot scheme has ended. If court-ordered private mediations prove successful, they may become the best way to deal with civil disputes.

The Government will be looking keenly at the outcome of the use of private mediators. The scheme has the potential to significantly increase the speed and quantity of civil cases dealt with in the High Court.

MEDIATION

For anyone who has ever been embroiled in any form of dispute, whether commercial or otherwise, it can seem that the cost of justice is prohibitively high. Lawyers cost money, filing documents in court is expensive and time consuming, and our courts are overloaded so the wait to appear in court is often long and the outcome is uncertain. It is little wonder then that many people turn to mediation as a means of resolving disputes, small or large, in a cost effective and timely manner.

The justice system has recognised the effectiveness of mediation. The High Court, District Court and Family Court are all utilizing mediation as a way to promote early resolution of matters rather than proceeding through the court process. Mediation is used to resolve such issues as tenancy disputes, employment disputes, civil disputes, claims to the Health and Disability Commissioner, claims under the Human Rights Act, community issues, environmental issues, and property disputes to name just a few. As you can see the application is endless.

For those of you who wish to resolve matters through mediation, below is a brief outline of what you can expect.

1. Depending on the type of dispute, mediation may be ordered by the court following the initial filing of an application. Alternatively, parties may agree that they will endeavour to resolve their differences through mediation and the parties themselves will choose a mediator.
2. There are many capable mediators in New Zealand (LEADR NZ and AMINZ, amongst others, may be contacted for a list of accredited mediators in your area).
3. You may retain your lawyer to assist with the mediation process if you choose, or you may attend mediation by yourself. Whether you wish

to retain your lawyer will often depend on the legal complexity of the issue.

4. Mediation will generally cost somewhere between \$3,000 to \$5,000 plus GST per day; however you should check this fee out with your mediator. The fee will usually be split between the parties and is therefore much less expensive than litigation.
5. The mediator will often meet separately with each party prior to mediation to gain an overview of the issues, discuss the mediation process with you and have an 'agreement to mediate' document signed.
6. Everything that occurs and is said at mediation is confidential to the parties except in circumstances where the parties agree otherwise.
7. On the day of the mediation the parties will meet together with the mediator. The mediator will make a brief opening statement and then each party will have an opportunity to make an opening statement setting out how they see the problem. The mediator will then identify the issues and the parties will agree on an agenda.
8. The parties will then be invited to address each agenda item and the mediator will assist the parties in this process. This is an opportunity to air grievances and express feelings, as well as discuss the facts and the merits of each party's case.
9. At any time during the process the mediator may wish to meet with a party individually to discuss issues in more depth and generate options for resolution. Anything that is said at that time is confidential and will not be repeated or referred to by the mediator when the parties meet together again.

Continued on page 6.

MEDIATION

Continued from page 5

9. There may be several independent sessions or none at all depending on the needs of the parties.
10. The mediator's role is to assist the parties to explore the issues and develop options for resolution, not to make a decision for the parties. If

the parties reach agreement this will be recorded in writing.

Mediation generally has a high settlement rate with reports of 75 – 80% of cases settling at mediation. For those who wish to know more about mediation there are several websites that explain the process in more detail.

NEW STAFF SOLICITOR JOINS BURROWES AND COMPANY



The team at Burrowes and Company has been joined by Simon Wilson, a recent law graduate from Otago University.

Simon's final papers at Otago included Trade, Company, Intellectual Property and Labour Law.

His legal interests are commercial, corporate and property law.

Simon grew up on his family's farm north of Dunedin and attended boarding school at John McGlashan College. Simon enjoys all types of sport especially fishing, golfing and skiing, as well as music and travelling.

SHAREE GETS MARRIED



As some may have noticed from the recent change of name, our staff solicitor Sharee Cavanaugh (nee MacLean) was married on 6 March 2010.

Sharee and her husband Jimmy Cavanaugh were married on a family farm in Dairy Flat north of Auckland. They were joined by about 90 guests, many of whom travelled from Wellington and Australia to be there.

Sharee tells us that they had a fantastic day, power cut and all! They also enjoyed a week-long honeymoon in Rarotonga.

We wish Sharee and Jimmy all the best for the years ahead.

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Burrowes and Company wish to acknowledge the contribution of Law Clerk Katherine Leslie in preparing this newsletter.