

BURROWES and Company



Barristers and Solicitors

Client Newsletter

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Incorporated Societies Reform

The Incorporated Societies Act 1908 is uncomfortably old and has been little amended since its enactment. Currently much of the not-for-profit sector in New Zealand is governed by this Act. The Act contains legal structures and rules which govern the many thousands of community organisations. The Act affects organisations as diverse as the New Zealand Rugby Union, swimming and soccer clubs to student societies.

The Law Commission is currently in the process of reviewing the Incorporated Societies Act 1908. They believe that a new Act is an important step to strengthening the non-profit sector even if such a review will not address all the issues that confront the sector. Commissioner Geoff McLay said it is critical the legal framework under which incorporated societies operate offers the right balance of autonomy, flexibility and accountability.

Following preliminary consultation and research, the substantial problems identified with the old Act include the lack of adequate processes for dealing with conflicts of interests and resolving internal disputes. The Law Commission has stated that “the 1908 Act, in our view, does not require societies to ask the appropriate questions when they are being set up. Nor does it provide incentives for already existing societies to improve.”

Central to the proposals of the Law Commission is a new statute which is in line with a modern approach to corporate governance. The new statute will provide default rules that entities may adopt and sets out better procedures to resolve disputes and control societies. However the Law Commission is mindful that there is a trade-off between seeking greater accountability and governance controls, and creating unnecessary compliance costs for community groups.

The Law Commission proposes that New Zealand should have a generic code of rules

governing entities. These rules could act as a default mechanism for those organisations that choose not to have their own specific rules. This is in response to many incorporated societies failing to have effective rules governing dispute resolution and conflicts of interest. A set of model rules would also be beneficial to incorporated societies which do not have the necessary skills and resources to create constitutions that serve them well.

A code of duties is also proposed which would set out the duties of members who are involved in decision making in which they have an interest. This code would be similar to several directors’ obligations in the Companies Act 1993 and serves the function of telling committee members what is expected of them in their official capacity.

In summary, the Commission is seeking feedback on a range of issues and options for reform raised in the paper including:

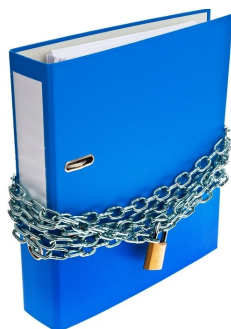
- Whether all societies should, as a condition of incorporation, be subject to certain minimum governance rules that they cannot vary;
- Whether a new Act ought to provide a code that makes the obligations of committee members clearer;
- How the Act should provide for the resolution of disputes between members and their societies;
- What rules societies ought to be required to have in their constitution, and the nature of those rules;
- Whether the new Incorporated Societies Act should replace the ability to incorporate under the Charitable Trusts Act.

The Law Commission paper seeks to establish where the balance lies between corporate governance and the flexibility and ease enjoyed under the 1908 Act. The views of the community are sought in regard to the Law Commission proposals. Submissions are due on 30 September 2011.

PROTECTING YOUR INTELLECTUAL PROPERTY FROM TRADING RISKS

Running a business has its risks – the ultimate being the entity going out of business and having to shut up shop. The recent recession increased such a risk for many businesses with some being unable to cope with the economic pressures and consequently becoming insolvent.

When a business becomes insolvent and is subsequently liquidated, the assets of the entity are seized and sold with the view to pay creditors. Intellectual property assets are no exception and assets such as domain names, trademarks and copyrights as well as concepts relating to branding are often lost in the process as well. More often than not, such intellectual property assets are irreplaceable. It is therefore important that time and effort is invested in protecting such assets in the event that a company is put into liquidation.



Separating assets into two or more legal entities as a means of protection has been common practice for some time, with business owners transferring their houses and other personal assets into trusts. However with intellectual property, while it is possible to register legal ownership rights in a trust (provided that ownership is recorded in the joint names of the trustees and not in the name of the trust itself) problems can arise relating to sub-licensing due to consent issues from co-owners. Additionally, the Intellectual Property Office of New Zealand is adopting a stricter interpretation of intellectual property laws that prohibits trusts from owning intellectual property.

The separation of assets through the use of limited liability companies is therefore a more suitable vehicle for the purposes of intellectual property asset protection. Separate ownership using companies requires the establishment of two or more registered companies where one company, Company A, owns the intellectual property and the other company, Company B, acquires a licence from Company A to sub-licence the intellectual property to clients.

All ownership of the intellectual property assets are vested in Company A, and Company B at no stage actually owns the intellectual property. In the event that Company B becomes insolvent, its creditors are not able to lay claim to the intellectual property assets by virtue of it being owned by a separate legal entity, Company A.

This model is particularly suited to software companies as they don't sell their products, but rather license them by granting a customer non-exclusive rights to use the software. The actual software remains the property of the original owner. The separate-ownership model can also be tailored to suit most business genres.

Although appropriate licences and insurance policies are worthy components of risk management, many policies do not guard against insolvency of a company or bankruptcy. As a consequence, while some effort may be required in setting up an appropriate structure, separating valuable intellectual property could be well worth the time and money.

TRUST REFORM

The Law Commission's fourth paper on trust law *The Duties, Office and Powers of the Trustee* bear witness to a very busy Law Commission and its focus on much needed law reform. This paper is principally concerned with trustees' duties and covers other important aspects such as what information should be available to beneficiaries.

The Commission notes that trustees' duties can be waived either wholly or partly, except the duty to act in good faith. Furthermore, there is an irreducible core of trustees' obligations that is fundamental to the concept of trust: to act honestly and in good faith for the benefit of the beneficiary. Added to this is a duty to act prudently and not disgorge trust assets by deliberate acts. The Commission is seeking submissions on whether new trust legislation should contain a list of trustees' duties and, from such a list, should there be a separate list of irreducible duties that can never be excluded or compromised.

Chapter 2 in the paper covers the important debate as to what extent trustees have a duty to inform beneficiaries. The Com-

mission notes that a balance needs to be struck between competing interests where trustees, who in many cases are volunteers, have primary obligations and ought not to be pestered with demands from beneficiaries. The debate has a focus on providing beneficiaries with relevant information to enable them to be satisfied that the administration of the trust is being conducted in accordance with the trust instrument and the current law.

In *Schmidt v Rosewood Trust Limited* the Privy Council rejected the proprietary approach in favour of basing beneficiaries' rights to information on the inherent jurisdiction of the Court. The Commission notes three possible options to adopt in any reform. The first being the principle in *Schmidt*, the second to specify the kinds of information that should be provided to qualified beneficiaries and the third would be to adopt a combined element of both general principle and list approach.

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THE UNIT TITLES ACT 2010

The Unit Titles Act 2010 (the '2010 Act') came into force on 20 June 2011 and replaced the Unit Titles Act 1972. The 2010 Act contains material changes from its predecessor and is now the principal authority pertaining to the establishment and management of developments such as apartment blocks, multi-layered commercial spaces and flats.

The key changes included in the 2010 Act are discussed below.

All common property in an establishment is now owned by the Body Corporate. Previously, ownership of common property was jointly vested in all unit owners. The change now allows the Body Corporate to more effectively promote the benefit of the development as a whole by representing all unit owners in relation to the improvement and maintenance of common property.

Responsibility for the maintenance of building elements and infrastructure affecting more than one unit now lies with the Body Corporate. This means for example, that the Body Corporate will be responsible for repairing a leak from a top floor apartment to a unit below (provided the leak is not attributable to the recklessness or negligence of the unit owner and/or occupier.) Previously, the obligation to remedy the leak would have fallen solely on the owner of the top floor apartment.

Minor alterations to individual units are now more feasible as the 2010 Act allows for increased flexibility relating to re-developments. Obtaining the consent of a body corporate is no longer required to carry out additions or structural alterations to units, provided the modifications do not materially affect the common property or the property of another owner.

The subdivision of principal units is also possible under the

2010 Act, allowing for the creation of a separate unit title development within the principal title known as a subsidiary. This is known as a layered development and allows for multiple use of a building – such as where a building has car parking, shopping complexes and apartments all within its confines.

The 2010 Act also allows for the creation of separate Bodies Corporate that govern subsidiary units, which are also part of the Head Body Corporate responsible for overall management of the development.



Unanimous consent of the Body Corporate is no longer required under the 2010 Act and a 75% majority is sufficient for decisions to be made. This change has been welcomed by many as it means decisions will less likely be held up by difficult owners.

Bodies Corporate are also required to develop long term maintenance plans in advance, giving owners the opportunity to pay regular instalments over time. This is to avoid owners having to pay large one-off special levies for work required on common property such as lifts.

The new Act requires vendors and their sale agents to provide a number of disclose statements; a "pre-contract" statement, a pre-settlement statement and the purchaser's ability to request additional disclosure statements. While this will increase the extent of information accessible to purchasers, vendors may face difficulties in meeting disclosure deadlines if body corporate records have not been kept up to date.

The 2010 Act seems to attempt to be more flexible and pragmatic. To some extent the 2010 Act may give unit title owners more certainty and therefore promote unit titles as a form of land ownership.

CHANGES TO GIFTING RULES FOR TRUSTS

Gift duty has been abolished due to the enactment of the Taxation (Remedial and Administration) Act 2011. The new rules have abolished gift duty on gifts made on or after 1 October 2011. While the previous rules charged gift duty on gifts of more than \$27,000 a year, the new rules will abolish gift duty altogether. Therefore, anyone is be able to gift any amount without paying a duty. This has make the transfer or gifting of assets easier.

On the face of it, these changes mean that an entire balance owing from a trust to its trustees be gifted to them in one lump sum without incurring gift duty. However there are other concerns which may affect your decision to gift the entire balance at one time.

The rules regarding rest home subsidies could mean that if a lump sum over \$27,000 is gifted by one person or a couple at one time, you will no longer be eligible for a subsidy. This may be seen as depriving yourself of assets where your finan-

cial position has changed so as to qualify for a benefit, such as the rest home subsidy.

Caution should also be exercised if you intend to gift once before October 2011 and then again within the same income tax year. If there is an incidence of gifting twice within this period, the IRD may chose to aggregate these gifts and charge gift duty on this amount.

The new rules will enable the transfer of assets to trusts without leaving an ongoing loan asset. This change may focus the attention of the IRD to whether trusts have been properly established and administered. The changes to gift duty rules certainly highlight that all structures involving trusts must be administered to a high standard.

We will be writing to clients with family trusts about their individual situations.

TRUST LAW REFORM

Continued from page 2

Chapter 3 in the paper covers exclusion of liability of trustee's provisions unless they are dishonest or fraudulent, but notes that such exclusions are at the high end of offending. There are various options put forward to make trustees more accountable. The most acceptable option is probably to excuse trustees from liability, provided they exercise reasonable skill and care.

Chapter 4 covers appointment and whether the Court should have a specific statutory power to remove anyone holding an appointment position where the Court considers

it inappropriate for the person to continue in that office.

The final chapter covers trustee powers and questions whether trustees should have the right to appoint agents to perform administrative functions and what safeguards on delegations should be imposed.

There are 77 problems posed in the Law Commission paper and no doubt there will be many more for the Law Commission to collate. This will hopefully produce a bill before too long to modernise trust law in New Zealand. This reform will enable more effective regulation of trusts, and encourage and promote far better management and administration.

EMPLOYERS TO DISCLOSE UNWRITTEN THOUGHTS

With thanks to Jaesen Sumner and Gretta O'Connell of Ford Sumner—www.fs-lawyers.com

The decision of the full Court in *Vice-Chancellor of Massey University v Wrigley* applied an exceptionally broad construction to an employer's obligation under 4(1A)(c) of the Employment Relations Act 2000 ("the Act") to disclose all "relevant" information to employees during a restructure. Section 4(1A)(c) of the Act governs employee access to relevant information if an employer is proposing to make a decision that may have an adverse effect on the continuation of employment.



The Facts

Two lecturers at Massey, Mr Wrigley ("W") and Dr Kelly ("K"), were made redundant. W and K claimed that Massey had failed to disclose all relevant information under s. 4 (1A) of the Act. Massey claimed that it had satisfied its statutory duty by providing W and K with sufficient information, including job descriptions for the new positions created, the identities of other candidates for those positions, selection criteria, information and individual assessment sheets from interviews, feedback from the selection panel and the selection panel's recommendations.

W and K claimed they were entitled to further information, including the interview sheets completed by each panel member, the assessment sheets of the successful candidates, handwritten notes of the selection panel, candidate comparison sheets and information in the minds of the selection panel members and/or decision makers that had not been committed to writing. Massey responded that the process was confidential and it would not release comments made by panel members during the selection process.

The Decision

The Court held that there is no need to restrict the normal meaning of the term "relevant" in s. 4(1A)(c) of the Act.

The Court ruled that "relevant" information may include both written and unwritten information, perceptions and opinions of those involved in the process (i.e. members of the selection committee and/or the decision maker). The Court advised that even though this information may be difficult to retrieve, this does not affect the question of whether the information is 'relevant'.

The Court ruled that the additional documentation sought by W and K should have been provided to them for their consideration, with the exception of "confidential information". However, in this case "confidentiality" was not a reason to withhold the information because the protection of privacy of those involved in the restructure process (i.e. selection panel members) was not a sufficiently good reason to maintain the confidentiality of the information. The Court also noted that the information requested was not of an intensely personal nature.

Implications for Employers

This decision may have significant implications for employers who commence a restructuring process, or any process that may have an adverse effect on an employee's employment (i.e. disciplinary process). It is clear that an employer must disclose all 'relevant' information relating to the continuation of employment and that the term 'relevant' will be interpreted broadly by the Courts.

We await with interest how the Courts will enforce an employer's obligation to disclose relevant unwritten thoughts and perceptions. We believe that this requirement is highly impractical and is likely to be unenforceable in practice. While disclosure obligations are likely to be elevated in larger companies who have specialist HR departments, this will not retract from a smaller employer's obligation to disclose all 'relevant' information. However, employers can take comfort in the fact that in many situations "confidential information" will remain a valid exception to the disclosure obligations under s. 4(1A)(c) and therefore it would be prudent for employers to seek legal advice regarding the exceptions to disclosure obligations prior to commencing a process.

APPEAL ON PROPERTY DEAL FAILS

When Mr Hinton retired he and his wife decided to purchase an investment property. They heard from a neighbour that two units in the Twin Peaks motel complex in Taupo were for sale. Mr and Mrs Smith owned the units.

The Smiths real estate agent was J B Aubin Realty (JBA). JBA's Mr Donnithorne was the agent who put together the sale. The units in Twin Peaks were owned by individual investors who bought strata titles and become members of a body corporate. A management company, MontDore, received 15 % of gross rent from guests renting the units, and also recovered servicing expenses, such as cleaning and laundry. Unit owners paid body corporate levies and rates.



While negotiating the purchase the Hintons asked for and got information on the rate of return on the units. Mrs Smith gave a handwritten note of the gross income and some costs to Donnithorne. The Hintons received the note. Later Donnithorne faxed the Hintons a handwritten note detailing the returns for each unit that indicated a 9.12% annual return for one unit and 8.48% for the other unit.

Soon after the sale was completed the Hintons found out that, once the MontDore deductions were taken into account, the return on each unit was about 2% a year. The Hintons went to the High Court asking for the agreement for sale and purchase to be cancelled, along with compensation for losses. The Smiths, JBA and Donnithorne cross-claimed against each other over who was liable to compensate the Hintons.

The High Court held that the Hintons could cancel the contract because the Smiths' handwritten note materially misrepresented the rates of return of the units. The Judge ordered the Smiths to purchase the units back from the Hintons and awarded the Hintons damages for costs in purchasing the units. The Judge apportioned responsibility for the Hintons loss as; 50% agents, 35% the Smith's, 15% the Hintons.

JBA, Donnithorne (the agents), and the Smiths appealed to the Court of Appeal regarding the apportionment of responsibility between them.

The Court of Appeal agreed with the High Court that the handwritten note representing return rates amounted to misrepresentation and to which the Hintons reasonably relied on when entering the purchase agreement.

The Hintons first claim for contractual misrepresentations was brought under the Contractual Remedies Act 1979 (CRA). They sought orders rescinding the agreement and requiring the Smiths to pay back the purchase price with interest and costs.

The second claim was that the Smiths breached the Fair Trading Act 1986 (FTA), as per their involvement directly or indirectly in misleading or deceptive misrepresentations.

The Hintons asked for orders under the FTA to have the agreement declared void and reverse the transaction. The Smiths and the agents both denied liability and raised contributory evidence on the part of the Hintons and both respective parties.

The Court of Appeal ruled that the handwritten facsimile representing net returns of around 9% was a material misrepresentation, which induced the Hintons to enter the agreement, and it was not unreasonable for the Hintons to have relied on the misrepresentation. The Judges said the Hintons could cancel the contract and the properties would vest in the Smiths on repayment of the original purchase price plus apportionments.

The Court of Appeal accepted the High Court's reasoning on apportionment. The CRA allowed for an order directing any party to pay to another party "such sum as the court thinks just". This gave the High Court Judge the power to do what he did. The Court of Appeal dismissed the appeals.

WEDDINGS AND WILLS

Death and Wills! This generally is not a typical topic of conversation when you are preparing for your wedding. But due consideration should be given to documents such as Wills and Contracting Out Agreements (i.e. Pre-Nuptial Agreements) as marriage imposes significant obligations in relation to property division and the allocation of assets.

If a person dies intestate (without leaving a Will), the allocation of their assets is determined by legislation such as the Property (Relationships) Act 1976 and may be divided differently to the way the person had envisioned it would be.

The advent of a new marriage also automatically invalidates all Wills that were made prior to the date of the marriage.

A review of a person's estate planning should also be undertaken prior to marriage as it too will be significantly affected. Consideration must be given to those who will benefit from a person's estate and legacy (a gift of personal property or money to a beneficiary of a Will). Failure to execute the requisite documents to reflect one's wishes can have negative consequences for all concerned.

CONGRATULATIONS, HEATHER

Heather Olls, our legal executive and practice manager, has recently become a Fellow of the New Zealand Institute of Legal Executives and is now authorised to take statutory declarations. To become a Fellow, a person must be qualified as a legal executive for at least five years. Heather commenced her career as a legal secretary in Johannesburg in 1991 and moved on to a legal executive role after obtaining her Legal Executive qualification. She joined Burrowes and Company when she moved to Wellington in 1999 and has been with the firm ever since. Heather's role focuses mainly on property sales and purchases, wills and trusts. She is also a



WELCOME, NICK



Nick Davis has recently joined the firm as a solicitor.

Nick is a graduate of Otago University and has four years post qualified experience. He has worked previously in a litigation role at a Lower Hutt firm before leaving to travel overseas for a year. Nick will be specialising in Commercial Law, including insurance law and resolution of insurance disputes.

WELCOME, FERN

Fern Wooldridge Hyett joined the firm as a law clerk in September.

Fern has been completing her law degree at Victoria University this year. She will be working full time for us over the summer period. Her legal interests include property and employment law.



GOOD LUCK TRACY

Tracy Best has been working part time for us as a junior solicitor over the past 6 months. Tracy (pictured on the left of Alberto Contador) is a top 10 New Zealand women's cyclist. She will be leaving New Zealand shortly to race in Europe. Tracy has experienced a wide variety of legal work during her time with us. Good luck Tracy!



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Burrowes and Company wish to acknowledge the contributions of Staff Solicitor Tracy Best and Law Clerk Jerry Govender in preparing this bulletin.