

Fineprint

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Pitfalls for Company Directors

Fair Trading Act 1986

"It wasn't me, it was my company" – The reason why people trade in companies.

But . . .

"It will be a rare case where a director who participates directly in negotiations as to his or her company's business will be able to avoid s.9 liability simply on the basis that he was acting only on the company's behalf." – Justice Heron in Kinsman v Cornfields Ltd and Others.

The first quote gives the reason why businesses use a company structure for trading. A company has a separate legal personality, meaning that the company (and the liabilities it could potentially face) are separated from those people behind the company.

In a limited liability company, if things go wrong, the liability of the company is limited to its assets. The assets of the company and the assets of its directors, servants and agents are separate, affording a considerable amount of protection to the directors, servants and agents.

The recent Court of Appeal decision in *Kinsman v Cornfields Ltd and Others* highlights the limitations of company liability, and emphasises the need for company directors in particular to ensure they have well-structured asset planning in place, in addition to the use of a company structure.

The facts

Mr Kinsman was the director of a gourmet burger restaurant company. It was successful so he set up a franchise. In negotiations with prospective franchise purchasers in another area, Mr Kinsman (on behalf of his company) made available some pro forma sales figures for his restaurant to show likely sales figures for the new franchise. The sales figures were described as "current".

Based on these sales figures, the other parties to the proceeding purchased a franchise. Unfortunately, it did not achieve the sales

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figures expected, and they contended that they had been misled by Mr Kinsman. They sued him personally (as a director of the company), as well as the company itself.

They relied on section 9 of the Fair Trading Act 1986:

No person shall, in trade, engage in conduct that is misleading or deceptive or is likely to mislead or deceive.

The High Court found that the sales figures were not current, as they had been represented to be, and that the figures for the critical period on which the decision to purchase was made were significantly less than the pro forma figures. The judge found both Mr Kinsman's company, and him personally, liable for a breach of the Fair Trading Act.

Appeal

Mr Kinsman appealed to the Court of Appeal on the basis that in providing the figures, he had merely done so as part of his duties with the company. He had acted on behalf of the company. He contended that if there was a liability, it was the company's alone.

The Court of Appeal had to decide whether the legislation was intended to erode the traditional protections of the company. The Court decided that the net of the Fair Trading Act was to be cast much wider than other statutes, and could impose personal liability on a company's directors, servants or agents for misleading conduct.

In doing so, the Court of Appeal created a

major exception to the rule that directors, under ordinary circumstances, are not liable for the sins of the company.

What is misleading conduct and should I worry?

The Act applies to anyone in trade (any trade, business, industry, profession, occupation, activity of commerce, or undertaking relating to the supply or acquisition of goods or services or to the disposition or acquisition of any interest in land). Misleading conduct is simply anything done that has the effect of making someone believe something that isn't so.

“ No person shall, in trade, engage in conduct that is misleading or deceptive or is likely to mislead or deceive.”

The problem though is that no intention to mislead is needed. You could mislead someone innocently, honestly believing you gave them the right information, but have misled them nonetheless. There are exceptions, such as the person who merely passes on information provided by another. Broad interpretations of the Fair Trading Act principles are applied in order to extend its protections as widely as possible, however these interpretations also widen the potential liabilities.

What does this mean for me?

Company directors, in particular, are probably the most vulnerable with this change to the extent of protection available from a company. The risk is heightened when the directors negotiate on behalf of the company, marketing goods and services.

You should ensure that proper asset planning has been put in place. All significant assets should be placed in a family trust. In addition to protecting assets from a business claim, a trust protects assets from the current asset testing scheme for rest home care (though asset testing will be phased out over the next five years). There are also potential tax advantages for directors in using family trusts.

In addition, you may be able to insure against your personal liability. This is a matter that should be raised with your insurance broker. Also, you can require the company to indemnify you for any personal liability you might have arising from your duties with the company. The effectiveness of the indemnity however depends on the company's ability to indemnify you (that is, it must have sufficient assets).

In a nutshell, the business arena has changed since this Court of Appeal decision. If you are running, or are a director of, a limited liability company you will realise that your personal assets may now be at risk if there is conduct that is misleading or likely to mislead or deceive.

Editorial

Welcome to the new look *Fineprint*. After six years publishing the newsletter in two colours, we thought it was time to make a splash, so here we are now in glorious technicolour.

With the new colours and a redesign of the format, we look forward to continue to bring you the wide range of articles, short items and occasional features that you say you enjoy reading. Best of all, you tell us that you find the material useful in both your personal and business lives.

The new-ish Post Script section, which offers useful short stories that allow you to access some fundamental information on burning issues before having to call us to deal with more complex matters, has been very popular.

In addition, it gives us the ability to react quickly to a news story and give you some comment.

We love to get feedback and comments on the newsletter, and suggestions on future articles for *Fineprint*.

Please continue to be in touch, we enjoy hearing from you.

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Editor

Bonds, Not So Boring

With the world's major sharemarkets having experienced a sustained run of volatility, investment in fixed interest investments is looking increasingly attractive to some people. Bonds (another name for fixed interest investments) are generally seen as a safer alternative, but essentially boring and no match for share returns in good years.

However, some commentators now believe that over the next few years, several bond types – 'hybrids' and high-quality corporate bonds – could give shares a good run for their money.

Hybrids

First of all, what are hybrids? Hybrid is the popular name for convertible preference shares. They are called hybrids because they combine the features of both fixed interest and shares. They are classed as an 'equity' for accounting and tax purposes, but – like bonds – they pay investors a regular fixed income stream – except the income from a hybrid is classed as a dividend. Furthermore, the yield (or income) is often higher than offered by 90-day bank bills.

Hybrids then convert into ordinary shares on a predetermined date at a share price set at the time of issue, or at the market

price around the time of conversion. Therefore, to get their money back, investors can either sell their hybrids 'pre-conversion' or sell their shares 'post-conversion'.

Hybrids also offer the security of ranking ahead of ordinary shares, but behind a company's other debt obligations. Their return patterns are also closer to fixed interest than to equities, which means they can be a useful complementary investment to shares.

Corporate bonds

Meanwhile, corporate bonds range from high-rated blue-chip 'debt' through to speculative junk bonds. As a useful benchmark, anything below a BBB rating is considered 'sub-investment grade' – which is another way of saying 'high risk'.

Getting a good return

Getting a good return for the risk you take is critical. Even when the sharemarkets do recover, investors need to bear in mind that medium to long-term returns are unlikely to revert to the double-digit returns of the mid-1990s. With total returns (yields plus any capital gains) from bond markets expected to average only slightly lower than shares, investors who prefer less risk may wish to talk to their advisers about how their portfolios are currently restructured.

Finally, a word of caution. No two bonds are alike, and – as with shares – diversification is essential.

Contact us for a referral to a local financial planner who meets industry best practice standards and who we are confident can provide investment recommendations and financial advice to maximise your financial security.

Relationship Property Agreements

Why so important?

In these times, where it seems couples are taking steps towards acquiring joint property earlier on in their relationships, the need for a relationship property agreement is becoming increasingly more important in order for each person's respective interests to be protected.

Contracting out agreements

The trend seems to be that couples are purchasing major assets such as houses fairly early on in their relationships. A reason for this may be that people, especially those in de facto relationships, feel more protected under the law with the February 2002 introduction of the Property (Relationships) Act 1976.

More often than not, these people want to enter into a "contracting out agreement"

pursuant to section 21 of the Act. This type of agreement recognises an individual's separate interests in the newly purchased asset and any other assets brought into the relationship. Entering into an agreement provides clarity, security and peace of mind for the parties concerned.

The Act requires that agreements follow certain requirements to be valid. One of these requirements is that each party obtains independent legal advice before signing the agreement. If a lawyer has acted for both of you during the course of your relationship and one of you wishes to continue to use the services of that lawyer in the division of your relationship property, you must have the written consent of the other party to do so. If the other party objects, you must seek legal advice elsewhere.

Relationship breakdown

On the breakdown of a relationship, property matters can be settled by implementing the agreement. This brings closure in a timely and cost-effective manner. If matters become acrimonious, court action may be needed which can be very drawn out and costly. If there are childcare arrangements to consider in the relationship break-up, these should be recorded as an Order of the Court not as part of the relationship property agreement.

In conclusion, whatever the nature of your relationship and your interest in any relationship property, we strongly recommend that you enter into a relationship property agreement to ensure that interest is protected.

Dairy Farm Sales

Fonterra share transfers

When a dairy farm settlement takes place, the Fonterra shares must be transferred from the vendor to the purchaser. This article gives some background on the structure of Fonterra shareholding and offers some advice on the transfer of Fonterra shares.

Fonterra has a co-operative structure of 100% dairy farmer ownership. The capital structure of Fonterra includes, amongst other things, company shares, supply redemption rights, peak notes and capital notes.

Company shares

Dairy farmers who are Fonterra supply shareholders are required to hold one share for every kilogram of milk solids they supply during the season. The number of shares required is calculated at the end of each season. Shareholders who have increased production will be required to either buy additional shares or surrender any supply redemption rights held. Conversely, shareholders who have decreased production may either surrender their excess shares or choose to be issued supply redemption rights.

At the end of each season, the share will be given a *Fair Value* that will apply to the following season. The 2003-2004 season share value is \$4.38 per share; a 14% increase over the 2002-2003 value.

Fonterra supply redemption rights

A supply redemption right gives the holder the right to either exchange each right for one share or surrender each right for cash. Supply redemption rights are issued to shareholders who elect to be issued them in exchange for shares that are being surrendered. Rights may not be transferred, except on a farm sale.

Shareholders must carefully consider the choice between resuming and retaining surplus shareholding. If they are likely to increase production in subsequent seasons and the value of Fonterra is increasing, then retaining shares will be the best option. If they are scaling down their operation they are best to resume the shares, as the value of supply redemption rights will not change over time.



Peak notes

Farmers supplying Fonterra are required to hold peak notes in proportion to litres supplied during the peak period of supply (according to their “peak production profile”). The peak notes are issued at \$30 each until the end of the 2003-2004 season. Excess peak notes can be either held or redeemed. The redemption and surrender price is the same as the issue price. Payment for the surrender of peak notes is most likely to be in Fonterra capital notes. Peak notes can be transferred to other shareholders.

Capital notes

A capital note is essentially a loan to Fonterra. Capital note holders will receive interest on the notes and they may be traded on the Stock Exchange.

Fonterra may issue capital notes to shareholders instead of paying them cash when any other capital instrument is surrendered.

Capital notes may be held by any person; you do not need to be a shareholder.

Transferring shares

Before signing an agreement for the sale of a dairy farm, the clauses required in relation to the transfer of the Fonterra shares must be considered carefully, particularly in relation to bonus issues. The sale will be conditional on Fonterra accepting the purchaser as its supplier for the property.

A Fonterra transfer form will need to be completed and signed by both the vendor and purchaser. This will transfer all shares, peak notes and supply redemption rights. In addition, a new supply/amalgamation application must be completed by the purchaser.

Good planning and a full awareness of all the issues relating to the transfer of Fonterra shares should ensure your dairy farm sale (or purchase) will go ahead smoothly.

Employment Agreements

Keep them current

Many small businesses may have a standard employment agreement that they have been using for years. However these agreements may be out-dated. This article offers some advice to make employment agreements current.

Employment and privacy legislation

Recent legislation has made several changes to what can and cannot be a part of an employment agreement. It is important that everyone knows their rights. What is stated in an agreement may actually be misleading or legally incorrect.

Redundancy

Under current law making an employee redundant is not quite as simple as being given notice to the effect that you cannot keep them on anymore. The courts have required employers to show that they have tried to help their staff to get another job, or that they have given them options to be appointed to a different position within the business, or at the very least the employee has been consulted.

Probation periods

Employers cannot simply terminate employment at the end of a probationary period stated in the agreement. Grounds must still exist to justify such termination.

Relying solely on the provisions in the agreement can result in the employer being required to pay not inconsiderable amounts of compensation (in addition to legal expenses).

A small amount of time spent on getting legal advice now could save a lot of hassle and expense in the long run.

New provisions

When reviewing the old agreement with your lawyer, a few extra moments spent on updating some areas would be well worth the time. Clauses setting out the firm's policy on computer access, personal internet and e-mail usage at work, ownership rights of inventions discovered during the course of employment, provisions for employees required to be on standby, drug testing, etc should all be included in an agreement.

“ A small amount of time spent on getting legal advice now could save a lot of hassle and expense in the long run.”

In all of these situations simply stating the employer's position from the outset can dispel misunderstanding later on. Talk with us when drafting new provisions; this will allow employers to address issues that may arise later on through having a comprehensive updated employment agreement in place.

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Postscript

Regulation still a huge issue for SMEs

The National Bank reports in a recent issue of its "Small Business Monitor" that regulation is still the biggest problem for small/medium-sized businesses (SMEs).

Worst of all is said to be the Resource Management Act (RMA). The legislation is said to increase the cost of doing business and disrupts market-driven solutions to resource allocation with inefficiency being the result.

Despite government initiatives to improve processes around the RMA such as increasing the resources of the Environment Court and the RMA Amendment Bill, resource management issues still account for one of the biggest problems facing small business in New Zealand.

Source: National Bank Small Business Monitor, April 2003

Retail spending drops

Retail sales have flattened out more than expected in the last few months. In figures recently released by Statistics New Zealand, retail spending decreased 0.3% rather than the 0.3% increase that was expected. However, the trend is still 2.7% ahead of the results from this time last year. The Auckland area was said to have taken the hardest hit in the retail sag.

Slumps were experienced in motor vehicle services, recreational goods, cafes and takeaways, furniture and floor coverings, appliances and accommodation, hotels and liquor sales.

However there was a sharp surge in motor vehicle sales. Food retailing and the hardware sector also experienced some buoyancy.

The main reasons for the overall downward retail spend is thought to be SARS, with the sharpest falls in the sectors servicing tourism.

Home business help

Running a business from home has its advantages, but there is also a downside to being a one-person-band. For tips, helpful advice and access to the free e-mailed newsletter, check out the website www.homebizbuzz.co.nz.

Oops!

Readers would have found it impossible to access the website noted in the article "Noxious Weeds" Post Script section (Page 6) of the Autumn 2003 issue. Clearly something rather poisonous got into our (usually) rigorous proofing system. Many thanks to the reader who pointed this out to us very quickly! The website address should have read: www.protectnz.govt.nz.