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Commercial eSpeaking

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Welcome to the late Autumn issue of *Commercial eSpeaking*. We hope you find the articles of interest. If you would like to talk further about any of the issues covered in this newsletter, please be in contact with us.

In this issue we have articles on:

Operating your Business as a Partnership: the advantages and disadvantages

While limited liability companies are the preferred business structure for most business operations, many tradespeople and other small businesses are operating as partnerships without fully realising the implications of doing so… *CONTINUE READING*

Warning for Prospective Directors: do your homework

A recent Court of Appeal decision shows that people who are contemplating accepting a company directorship at a time when that company is involved in the raising of share capital should do their homework to ensure the company has complied with the statutory requirements for capital raising… *CONTINUE READING*

Business Briefs

Government review of personal grievance process – Financial adviser update – Mortgagee sales and charging orders – Anti-Counterfeiting Trade Agreement…
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The next issue of Commercial eSpeaking *will be published in September 2010.*

NZLAW
AN ASSOCIATION OF INDEPENDENT LEGAL PRACTICES

Operating your Business as a Partnership

The advantages and disadvantages

While limited liability companies are the preferred business structure for most business operations, many tradespeople and other small businesses are operating as partnerships without fully realising the implications of doing so.

Partnerships[1] are subject to the Partnerships Act 1908 (the PA) which describes an ordinary partnership as a group of people (two or more) carrying on business in common with a view to profit. The only exception is shareholders of a company. This means that any family members (including spouses) or any other group of individuals in business together, who are not shareholders of a limited liability company, may very likely be operating as a partnership.

Advantages

A partnership is a relatively simple business structure and is best suited to circumstances where there are a small number of partners with a mutual trust and familiarity between them. The main advantage of a partnership is that it allows the partners to pool resources and share both expenses and profits.

There are no formal registration requirements on a partnership (other than for GST) and there is no legal obligation on partners to formalise their arrangement in writing. However, it is prudent to have the arrangements between partners recorded in writing into a formal partnership agreement. For the most part the partnership agreement will be the primary source of rules that govern the partnership; however some sections of the PA may prevail over the terms of the partnership agreement. If a partnership does not have a partnership agreement it will be governed by the PA and the court cases which have interpreted the legislation. Accordingly, all partnerships should familiarise themselves with their obligations under the PA.

Unlike a limited liability company, there is only one level of taxation (personal tax) imposed on partnerships in respect of income derived from a person through the partnership. Furthermore, capital gain can flow through the partners on a tax-free basis, as and when those gains are realised. Comparatively, a company an only distribute a tax-free capital gain to shareholders when the company is liquidated. If you operate our business as a partnership, you may wish to discuss the tax implications of a partnership in more detail with your tax adviser.

Disadvantages

Although there are some advantages for operating a business as a partnership, it is likely that these advantages are outweighed by the fact that partners in a partnership have unlimited personal liability for the partnership's actions and conduct. This arises as a partnership, unlike a limited liability company, is not a separate legal entity and partners expose their personal assets to creditors of the partnership.

Furthermore, if you operate a business as a partnership you need to be aware that the actions of one partner will usually bind all other partners in the partnership, even if that partner has acted on their own initiative without the other partners' consent or knowledge. All partners may also be found personally liable if one of them commits a criminal offence in the course of the business. Therefore, partners must be confident that they can trust their fellow partners to comply with their obligations to act with the utmost good faith.

If you are concerned about the structure of your business or you would like further advice on alternative business structures, such as limited liability companies, please talk with us. Even if a partnership remains your preferred way of doing business, you should consider how best to protect your assets from liability of or any action taken against the partnership.

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1 This article does not apply to limited partnerships created under the Limited Partnerships Act 2008.

Warning for Prospective Directors

Do your homework

A recent Court of Appeal decision shows that people who are contemplating accepting a company directorship at a time when that company is involved in the raising of share capital should do their homework to ensure the company has complied with the statutory requirements for capital raising.

This case, *Chean v De Alwis*[2], has shown that where a company has breached statutory requirements, then a newly appointed company director can, in certain circumstances, be held personally liable for losses incurred by those who invest in the company where those losses stem from events that occurred before the director's appointment.

The case

Mr Chean, owner of Luvit Foods, wanted to attract new investors to the company in order to expand its business into a new venture. He provided various potential investors with a document referred to as an 'Information Memorandum' which, unfortunately, contained misleading statements and an improper financial forecast. The potential investors were later found to be part of the 'general public' for the purposes of the Securities Act 1978 and, as a result, before seeking contributions, the company should have issued the requisite prospectus under that legislation; this it did not do. Nonetheless, people invested a total of $1,600,000 and these funds were variously received 'on behalf' of the company into a joint bank account controlled by Mr Chean and his wife personally.

Luvit Foods then failed, and the investors sued Mr Chean personally to recover their contributions. Mr Chean then declared himself bankrupt although the court proceedings went ahead, and the court found Mr Chean to be personally liable under the Fair Trading Act 1986 for the losses suffered by the investors. The court also found that a prospectus should have been issued.

Presumably, that outcome represented a hollow victory for the investors because they then brought a separate action against the owner's wife. Mrs Chean was not a director at the time of the capital raising. However, she was subsequently appointed as a director and, in the hearing before the Court of Appeal, it was found nonetheless that the relationship between her and Luvit Foods at the time of the capital raising was sufficient to make her what the court referred to as a 'privy' of the company.

Despite the contrary arguments advanced by Mrs Chean, the court found that the money the investors had paid into the joint account was in fact subscription money. However, the court was not satisfied and ordered a retrial of the issue whether Mrs Chean actually knew that the allotment of shares to the investors was void under the Securities Act because of the absence of a prospectus and related Securities Act requirements.

If Mrs Chean did know of these requirements then she would have been bound by a statutory trust triggered by the Securities Act which would have left her personally liable to repay the investors.

And this is where the matter rests pending a further determination.

Conclusion

Although this Court of Appeal decision is likely to be relevant to very few company directors there is, however, a sharp lesson to be learned for those contemplating company directorships – we recommend you do your homework first.

Business Briefs

Government review of personal grievance process

The government has signalled that changes to employment law may be on the way. In March the Department of Labour released a discussion document on the personal grievance process and sought submissions from the public; these closed on 31 March. Topics on which the Department sought submissions included the role of employment advocates, 'no win, no fee' arrangements, extending the 90-day trial period and the costs of resolving personal grievances. The final report based on the review will be provided to the Minister of Labour this month and it is expected it will be released to the public mid-year.

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2 Chean v De Alwis [2010] NZCA 30

Financial adviser update

In December 2008, two pieces of legislation were passed that regulate the financial adviser sector: the Financial Advisers Act 2008 (FAA) and the Financial Service Providers (Registration and Dispute Resolution) Act 2008. The Minister of Commerce has announced that full implementation of the legislation and related regulation has been pushed out, from 1 December 2010 to **1 June 2011**.

All financial service providers must still be registered and be party to a dispute resolution scheme by 1 December 2010. However, financial advisers wanting to provide financial advice on securities or wanting to provide financial planning services will now have until June 2011 to complete all necessary training and authorisation. Similarly, organisations seeking Qualified Financial Entity (QFE) status will have to be approved by June 2011.

Two other recent developments are the release of the:

» Minister of Commerce's recommendations on the regulations to be passed under the FAA regarding the disclosure required by financial advisers; and a

» Draft Code of Professional Conduct (that will regulate Authorised Financial Advisers) on 31 March 2010; submissions on the draft closed on 7 May 2010.

Mortgagee sales and charging orders

Charging orders are orders that can be obtained against land to prevent a party from selling the property until debts are paid in full. For example, a party can seek a charging order under the Construction Contracts Act 2002 where it has not been paid for work completed. The charging order does not force the sale of the land, but stops the owner selling its land to defeat the debt due.

Land Information New Zealand (LINZ) has issued a ruling dealing with charging orders versus the power of a mortgagee to sell land if the owner has defaulted under a mortgage. If the mortgage was registered on the title before the charging order, in the past LINZ would not register a transfer resulting from a bank/mortgagee sale while a charging order was registered on the title. This meant that a mortgagee generally had to apply to the court to have a charging order removed if the chargeholder did not consent. LINZ took this view based on an interpretation of s105 of the Land Transfer Act 1952.

Following a High Court decision in May 2009[3], the Registrar-General of Land has ruled that LINZ will now automatically remove a charging order under s105 on registration of a transfer by a bank/mortgagee that has exercised its power of sale under a prior mortgage. So, a charging order will no longer protect a person who is owed money if a mortgagee sale is undertaken (pursuant to a prior mortgage).

Anti-Counterfeiting Trade Agreement

The Anti-Counterfeiting Trade Agreement (ACTA) is a plurilateral treaty being negotiated between a number of countries including the US, European Union, Canada, Australia, South Korea, Japan and New Zealand. The most recent round of negotiations was held in Wellington in mid-April 2010 and it is intended that the agreement be finalised this year for local adoption in 2011.

The draft agreement's stated aim is to strengthen and harmonise enforcement of intellectual property law internationally rather than make substantive changes to underlying liability. However certain proposals, if adopted, would go further than that – particularly with respect to online infringement of copyright and trademarks. In particular, suggestions for increased ISP liability for infringement by ISP customers, changes to ISP safe harbours, intellectual property owner access to ISP customer details, statutory damages for infringement and strengthened recognition of technological protection measures (TPMs), would all require significant changes to New Zealand law.

Fortunately, the secrecy in which the negotiations were previously held has been relaxed due to public pressure and the latest draft of the negotiating text of the agreement has been published, see **http://trade.ec.europa.eu/doclib/docs/2010/april/tradoc_146029.pdf**. The next round of negotiations is due to be held in Switzerland starting 28 June 2010.

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3 Gill Construction Company Limited v Morgan and Morgan HC WN CIV-2009-406-100 1 May 2009