

March 2006

The New Year is well and truly upon us. This issue of ASCO Brief has a definite focus on business issues, with an introduction to the New Zealand Fair Trading Coalition and their proposals for legislative reform, plus information on the survey by the Ministry of Economic Development on barriers faced by SME's accessing overseas markets. There is also a look at strategies for protecting your assets.

Financial Reporting Act reforms

In December the Government agreed to undertake reforms of the Financial Reporting Act 1993. The reforms are aimed at reducing compliance costs especially for overseas and small companies. This follows a review of the Act by the Cabinet Business Committee which proposals for changes to the Act include:

1. Removing excessive financial statement preparation, audit and filing requirements imposed on some small companies by amending the Exempt Companies System so that a company is exempt if it meets two out of the following three criteria:
 - Total assets of less than \$1 million
 - Annual turnover of less than \$2 million
 - Five or fewer full time equivalent employees
2. Removing the requirement on overseas owned companies to file audited financial statements if they qualify for differential reporting or exempt company status. The Framework for Differential Reporting provides exemptions from compliance from the full standards for certain medium and small entities that do not have public accountability.
3. That non-trading entities should not have any requirements to prepare financial statements subject to filing with the Registrar of Companies a statement that the entity has not been involved in any transactions during the course of the financial year.
4. Empowering the Accounting Standards Review Board to grant exemptions from specific requirements of the Act where full compliance would be impracticable or unreasonable
5. That as an alternative to sending annual reports to shareholders companies will have the option of notifying shareholders of the availability of annual reports in hard copy or electronic form.

The aim is to include the proposed changes in a Business Law Reform Bill in the next few months with a view to enactment before the end of 2006.

Financial Reporting Act Convictions

The Registrar of Companies has recently prosecuted several directors for failing to comply with the reporting requirements of the Financial Reporting Act 1993. This serves as a timely reminder to all directors that it is their duty to ensure that financial statements are registered on time. Certain companies are required to file financial statements under the Act and these must be filed within 20 working days of the date they are required to be signed. In the majority of cases financial statements must be signed within 5 months of the companies balance date. A summary of convictions provided by the Registrar of Companies shows that the individual directors concerned were fined \$6,000 each and \$130 court costs for failure to comply

Changes to the Incorporated Societies Act 1908

Some minor changes have been made to the Incorporated Societies Act 1908 which will make filing requirements easier. Changes include; only one copy of the rules needs to be submitted on application for incorporation, it is not compulsory to affix a common seal when signing as member applicant for incorporation and the register of members no longer needs to record occupations. The changes came into effect on 2 December 2005.

Proposals for legislative reform to assist SME's

The New Zealand Fair Trade Coalition ("NZFTC") was launched in Wellington on 1 June 2005. It describes itself as a "group of like minded organisations promoting best practice, sound business ethics and fair and vigorous competition". It has proposed a number of legislative changes which it believes will assist small and medium business enterprises ("SME's") and create a level playing field for such organisations. The NZFTC believes that the reforms it proposes are based on principles of fair business and "have at their heart irrevocable principles of strong business ethics and "Best Practice"". It is committed to changes in the New Zealand legislation governing business relationships.

Organisations which are members of the NZFTC include; Motor Trade Association of New Zealand Vegetable & Potato Growers Federation (Inc), New Zealand Contractors Federation (Inc), NZ Taxi Federation Inc, Bus and Coach Association (NZ) Inc and the Electrical Contractors Association of New Zealand Inc.

The NZFTC is seeking reforms in the following areas:

1. **Prohibiting unconscionable conduct** – the NZFTC believes that there should be statutory prohibition against unconscionable, unfair or harsh conduct in business and consumer transactions. It believes that SME's and consumers are at risk of large organisations engaging in unconscionable conduct, for instance:

- (a) Unilateral variation of a contract
- (b) The termination of a contract without just cause or due process
- (c) The presentation of "take it or leave it" contracts or agreements

This is particularly so where:

- One party knows or ought to know that the weaker party did not fully understand the transaction
- There is no real opportunity for the weaker party to bargain
- The contract is one sided
- One party imposes excessive terms and prices on the other
- One party uses a position of power to impose unreasonable conditions

The NZFTC has proposed that the Commerce Act 1986 should be amended to include a general prohibition against unconscionable conduct in consumer transactions and business transactions and the Commerce Commission should be able to initiate actions under these provisions.

2. **Allowing codes of practice** – In New Zealand there is currently no statutory provision which allows for the establishment of industry codes or their ability to be given the force of law. Current industry codes are generally voluntary. The NZFTC believes that codes of practice are a timely, specific, efficient way of providing guidance to an industry without having to engage the legislative process. It has recommended that the Commerce Act 1986 be amended to include a section which provides that regulations can be passed which prescribe an industry code, declare whether an industry code is mandatory or voluntary and provide that an organisation must not in trade or in commerce contravene an applicable industry code.

3. **Granting SME's the right of collective bargaining** – in this context "collective bargaining" refers to a situation where several competitors in an industry come together to negotiate the terms and conditions of supply or purchase with another usually larger organisation. Collective bargaining is currently prohibited under the Commerce Act 1986 but can be authorised by the Commerce Commission if the public benefit outweighs any loss in competition. However, there are substantial legal costs and significant time delays before any such authorisation will be granted. The NZFTC has recommended that the Commerce Act 1986 be amended to establish a process for the notification of collective bargaining which would provide the notifier (subject to certain checks) with immunity from the prohibitions in the Act. The Commission would be able to revoke immunity if satisfied that the conduct does not result in a net public benefit.

4. **Franchise Legislation** – there is no franchise specific legislation in New Zealand. Currently franchising is dealt with under the general commercial law. Principles of contract law and legislation such as the Fair Trading Act 1986, the Commerce Act 1986 and the Contractual Remedies Act 1979 apply. The NZFTC believes there are sufficient areas of concern in the franchising context to justify the need for specific franchise legislation. Areas of concern include:

- (a) Disclosure of information prior to entry into the franchise relationship
- (b) The terms of the franchise agreement – including lack of cooling off period.
- (c) Termination of the franchise agreement without good reason or without appropriate notice.
- (d) Resolution of disputes.
- (e) The ability of the franchisor to veto the right of the franchisee to on-sell its business.
- (f) Imposition of mandatory promotions on franchisees without any discussion with the franchisee.

All of (a) to (d) are already covered in the Code of Practice of the Franchise Association of New Zealand Inc and are mandatory on Association Members. The Association's Code of Ethics also imposes further obligations.

The NZFTC recommends that any such franchising legislation be modelled on the Australian Franchising Code. It should be stand alone legislation and be able to be enforced by both individuals and the Commerce Commission. Elements of such legislation should include the following requirements:

- Receipt of formal disclosure document by franchisees prior to entering into a franchise agreement
- Franchisees receive a 7 day cooling off period
- The franchisee must receive independent advice from a legal adviser, business adviser or accountant prior to entry into the franchise agreement
- The right of a franchisee to form an association with other franchisees
- Requirement for ongoing disclosure by franchisors of a material change in the circumstances affecting the business
- The right to obtain an audited statement from the franchisor regarding payments made by Franchisees to a marketing or other co-operative fund.
- Franchisee to receive sufficient notice and adequate reasons in advance of any termination of the agreement by the franchisor
- Provisions to enable the franchisee to sell its business in certain circumstances
- Franchisor to engage in negotiation and consultation procedures with its franchisees with regard to proposed promotions.

The NZFTC has also recommended that the penalties for breaching such legislation should be the same as for the Australian Franchising Code, i.e. injunctions, damages, enforceable undertakings, corrective advertising and other orders.

In addition to the reforms summarised above, the NZFTC also believes that there are a range of things which would be considered to enhance the contribution of SME's to New Zealand economy. There are:

- Putting measures in place to ensure that the Ministry of Economic Development operates as a true champion for SME's within government;
- Clarifying the role and responsibilities of the Small Business Advisory Group and enhancing its profile with SME's;
- Focusing on best practice within industries and emphasis on the importance of the continuation of education within industries themselves; and
- Provision of a low cost efficient dispute resolution mechanism.

The NZFTC has said that it will "vigorously pursue with parliamentarians of all parties the objectives of change through legislative reforms" and "will be urging the development of a consensus on this for prompt action so that SME's are able to contribute to productivity growth to their fullest potential".

For more information on the NZFTC, visit their website www.nzftc.org.nz.

What do we think about the NZFTC's proposals for reform?

We have reviewed the papers prepared by the NZFTC in relation to each of their proposals for economic reform. All of the main proposals involve the Commerce Commission taking on a larger role than its existing one. For instance, in relation to the proposal regarding unconscionable conduct the NZFTC has proposed that the Commerce Commission should be able to initiate actions in respect of prohibitions against unconscionable conduct; the proposal regarding codes of practice involves either the Ministry of Economic Development or the Commerce Commission endorsing codes of practice, the proposal regarding collective bargaining recommends that the Commerce Commission be involved in the notification process and the proposal recommending franchise legislation involves enforcement by the Commerce Commission.

In our view whilst the legislative reforms proposed by the NZFTC may seem reasonable, the practical reality is that they will mean very little to most SME's if the Commerce Commission refuses to take action and the SME itself is unable to fund the cost of proceeding with the complaint. (See below for information on when the Commerce Commission will take action).

Considerable further investigation needs to be carried out to ensure that the legislative reforms recommended by the NZFTC will in fact translate to practical benefits for businesses, including SME's. There may also need to be an investigation in the ability of the Commerce Commission to investigate complaints.

What we do applaud is the NZFTC's proposal for the provision of a low cost efficient dispute resolution mechanism if this is done correctly. The costs involved in litigation often put off potential litigants even when their case has merit. Mediation can be expensive and arbitration is very inflexible and can be very expensive. We believe that an efficient professional low cost dispute resolution services may be a positive development in business, provided that the rules on which it is operating are fair and proper, and do not allow enforced subjective decision making, especially in a context of legal uncertainty. The distinguishing feature of the most economically successful countries of the developed world are the rule of law and the enforceability of contracts.

When will the Commission take action?

Due to the volume of complaints the Commission receives and the funding restrictions on it, the Commission exercises

considerable discretion when deciding whether or not to investigate a particular complaint. It has developed certain enforcement criteria to assist it in making the decision whether to investigate or not. **The criteria the Commission looks at** are firstly the extent of the detriment (the greater the level of detriment the more likely the Commission will take action). In this regard the Commission considers certain questions including: Are the more vulnerable targeted by the behaviour? Are excess profits likely to be gained? Are consumers or businesses likely to suffer and to what extent? Secondly, the Commission looks at the seriousness of the conduct and considers questions such as: Is the conduct deliberate, reckless or very careless? Is the conduct repeat or ongoing behaviour? Is there a serious departure from expected lawful commercial behaviour? Is the conduct/information difficult to detect by businesses or consumers? Can the conduct be undone? Is the likely to be a contravention of a per se provision? Lastly the Commission considers the public interest, for example; Is there likely to be widespread public interest in the issue? Would a decision not to commence or continue enforcement action likely undermine public confidence in the law? Is it more appropriate for the Commission rather than another agency to address the issue? Are there any mitigating or aggravating features involved? Do the personal circumstances of the parties involved argue for or against enforcement action? Is there a significant need to clarify the law? Are the issues timely?

After considering the complaint in question and asking the above question the Commission's response will be one of the following:

- No further enforcement action required
- Compliance Advice letter
- Warning letter
- Settlement
- Decision to prosecute.

In this way it can be seen that the Commerce Commission will not investigate every complaint it receives. Even complaints which have merit may not be proceeded with if they do not meet the enforcement criteria.

Are you protected?

Given the recent warnings of doom and gloom on the economic horizon it may be appropriate to review what steps you have taken to protect your assets. Even if this does not worry you there is the fact that you will not be eligible for a rest home subsidy in later life if you have assets of more than \$150,000 for individuals or \$300,000 for couples (these thresholds will increase by \$10,000 on 1 July 2006). Your "assets" for this purpose include any cash or savings you may have, investments, shares, loans made to other people (including to family trusts), gifts made in the last 5 years over \$5,000 each and your house, chattels and car. If you don't qualify for a subsidy Work and Income can lend this to you but it will have to be repaid when you sell your house or out of your estate.

One way you can preserve your assets and still be eligible for the Rest Home Subsidy is to set up a family trust and transfer your assets to that trust. This will involve you gifting the value of the assets to the trust over a period of time. Work and Income current policy is not to look back at gifts made more than 5 years before you apply for the subsidy. It is therefore of vital importance that you set up a family trust now and start the gifting process.

It is also of vital importance that any trust that is set up is administered correctly. The IRD and WINZ may deem trusts which are not administered properly as "sham trusts" and ineffective.

Another situation which concerns many is the risk that assets which they have accumulated and see as ultimately going to their children may well go off to a stranger if the assets are not protected through the operation of the Property (Relationships) Act 1976 and other legislation.

We can assist you with setting up a family trust (and explain what they are about and how they work) and with the ongoing administration of trusts. Please call us to discuss.

For further information on the issues raised in this issue of ASCO Brief, please contact either:

Miles on (09) 308 8075 or
Lizandra on (09) 308 8076