
STARTUPS LEGAL TOOLKIT
**A PRACTICAL GUIDE
FOR ENTREPRENEURS IN
AOTEAROA NEW ZEALAND**

PARRY FIELD LAWYERS

ParryField
Lawyers



To the heart of what matters.



Even early-stage entrepreneurs need to think carefully about the legal foundations for their business. This guide is a great way to get your head sorted so you can move on with confidence and do what you do best.

**Marian Johnson,
Ministry of Awesome**



STARTUPS LEGAL TOOLKIT

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The information contained in this outline is of a general nature, should only be used as a guide and does not amount to legal advice. It should not be used or relied upon as a substitute for detailed advice or as a basis for formulating decisions. Special considerations apply to individual fact situations.

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INTRODUCTION ABOUT PARRY FIELD LAWYERS

What makes us unique?

Our team of around 75 staff work closely together in the areas of Property, Advisory and Disputes. We think that gives us unique advantages as we can be fast moving and nimble. Having the size to deal with major transactions, our rates are more competitive than larger operators.

Our Vision

Heart: Provide practical legal guidance while integrating our core values into our practice

Team: Implement a team environment that unleashes and empowers every individual.

Growth: Develop new and enduring relationships. Explore innovative approaches to legal practice

To the heart of what matters

We see our clients in a rounded way and want to help them with 'what really matters', for legal services and beyond, if appropriate.

Property: Our property specialists offer comprehensive advice on matters of all sizes. At the end of the day, you are not just another client. We want to personally help you achieve your property goals, whether big or small, with confidence.

Advisory: We support those involved in business, whether big or small, and whether at the early stages in forming a company or entering into a joint venture, ongoing support and compliance, raising capital, or assisting with the sale of the business to a purchaser.

We come alongside business owners and seek to fully understand your market and industry so we can provide the best advice possible.

Disputes: We act for both individuals and organisations, providing comprehensive, well- reasoned legal advice, combined with pro-active and creative solutions.

Our aim is not just to provide sound legal advice but resolutions which deliver the best practical outcome for clients.

Charity and social enterprises

We specialise in the representation of non-profit, tax-exempt organisations, including charities, charitable trusts, private foundations, social enterprises, social welfare organisations, public and private schools, (whether company-sponsored or family- endowed), tertiary institutions, churches and religious organisations as well as organisations that support this sector.

Taking an innovative approach

Gaining a better understanding of the business of our clients and solidifying relationships with them is a priority for us. Sometimes things call for a different approach.

We are also a tech- focused law firm with a team that enjoys working with start-ups, tech companies and other new businesses seeking angel investors.

We help our clients to get their legal structures right from the beginning. We're proud of our team and our approach – applying fresh thinking to the way law firms traditionally work with their clients.

So you want to start a business?

New Zealand is one of the easiest countries in the world to start a business. However, the phrase “easy in, easy out” can also apply. What are the key elements to ensuring that you survive as a business? This toolkit addresses the key points to ensure you start with the foundation of a well-structured business.

We call it a toolkit because each aspect of your business will need some work with a specific tool – the information here will help explain topics like structures, privacy, employment, intellectual property and fundraising.

We recognise that you can’t afford to throw buckets of money on legal structures, complex advice or even some of the more basic documentation needed in your first few months of setting up a business. So, it comes down to making clever choices around what is most important and also becoming better informed about what lies ahead and when to take the next steps with structuring your business.

Although lawyers are traditionally known for helping with the structures (companies, partnerships, trusts etc) or processes (sale of shares, leases, confidentiality agreements etc.) one of the best ways to get value out of our experience is to talk with us before you commit to any agreements at all. A good commercial lawyer will tell you what you need to do now and what you can leave for later.

This toolkit is designed to talk about some of the processes that you will need to think about along the way and hopefully will alert you to how to ask better questions and to see how the various legal issues.

We look forward to working with you and also pointing you in right direction.

All the best with your venture!



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Contact Us

This document is not a substitute for legal advice and you should consult your lawyer about your specific situation. Please feel free to contact us at Parry Field Lawyers



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PART A HOW TO SET UP A COMPANY

Chapter 1: Is a company best? Options for business structures.

When embarking on your entrepreneurial endeavor, the company structure may be the only form you consider. However other alternatives are out there, and may even provide a better fit for you.

Before we dive into the detail of structures we need to get one thing straight: What is your purpose. Get clear on that and your strategy first before you get into choosing the legal structure that will be right for you. Too often a structure is chosen when actually better understanding things like motivations of the founders, where funding will come from and what investors will expect would have changed what entity type was chosen.

INCORPORATED COMPANY

The company structure is one of the most commonly used forms in New Zealand. Its creation forms a separate legal entity to the people involved. When the company has limited liability, this means that shareholders are only liable for the company's debts up to the value that they paid for their shares. For information on how to incorporate a company, turn to Chapter 2. Adopting a company structure will impose certain obligations on your directors and shareholders. Read more about these duties in Chapter 12.

LIMITED PARTNERSHIP

Limited partnerships in New Zealand are governed by the Limited Partnerships Act 2008. A limited partnership must have at least one general partner and one limited partner (who cannot be the same person at the same time). The general partner is responsible for the day to day management of the limited partnership and is liable for all of the limited partnership's debts and liabilities, to the extent that the limited partnership cannot pay those debts and liabilities. The limited liability partner is liable only to the extent of its capital contribution to the limited partnership.

JOINT VENTURE

A joint venture in New Zealand is an arrangement between two or more parties who combine together to invest capital or resources in a particular project. A joint venture can be carried out in one of three ways:

- by a company incorporated under the Companies Act;
- by a partnership (including a limited partnership); or
- by an unincorporated contractual joint venture.

An unincorporated joint venture involves the parties entering into a written joint venture agreement. The assets of an unincorporated joint venture are owned by the joint venture parties as tenants in common in the proportions agreed between them.

Legal advice is important to ensure the joint venture is not classified as a partnership.

SOLE TRADER

A sole trader is someone who engages in business without registering as a company. This is how many small business owners, contractors and self-employed people begin. There are no legal and registration fees, but you will be personally liable for all debts.

TRADING TRUST

A trust is used to protect your assets. It will own your assets and look after them for the people who benefit from the trust. A trust can also be used in business, and usually a company acts as the trustee. The trustee company will operate the business for the benefit of the beneficiaries of the trust. While there is greater flexibility than under a company, operating such a trust can be quite complicated. It would be highly advisable to discuss the option with your accountant and lawyer before proceeding further.

This is an introduction - we have done a more detailed analysis of structure options here:

<https://www.parryfield.com/structures-for-business-which-is-best-for-you/>

Chapter 2: How to set up a company

We often get people who have a great idea and want to know how to set up a company. This chapter will explain the key things you need to decide on and the steps to take to do this. While we are able to help with the setting up of standard companies and the steps outlined here, it is more efficient and cost effective for you to do it yourself. Where we can add value is more on the “bird’s eye” view around the form of legal structure, how to set out the way decisions are made among shareholders and directors and assisting with other legal set up questions around Intellectual Property, employees and the leasing of office space. In particular you may need a special constitution and a shareholders’ agreement.

WHAT DO I NEED TO SET UP A COMPANY?

Setting up a company has a different meaning to setting up in business, as you are creating a separate legal entity. At its core, a company must have a few essential things:

- A company name;
- At least 1 share;
- At least 1 shareholder;
- At least 1 director who resides in New Zealand; and
- Contact addresses.

Now let’s turn to look at the steps involved.

RESERVE THE COMPANY NAME

This is the first step in creating your company. Under the Companies Act 1993, you need to have reserved your company name before the Registrar can register your company. To begin, you will need to have a RealMe® login and an online services account with the Companies Register. It is important that you thoroughly do your research before choosing a name. The Companies Act 1993 states that the Registrar must not reserve a name if it:

- would breach New Zealand law;
- is identical or almost identical to the name of another company; or
- is offensive in the opinion of the Registrar.

Visit onecheck.business.govt.nz to search whether the company name, domain and trademarks are available. Once you are certain that the name will be appropriate, head to the Companies Register to apply to reserve the name.

It will cost \$10 (plus GST) to do so. For step by step instructions on how to complete the application, go to the Companies Register website. Once your application has been approved, they will send you a confirmation email. From then on, you will have 20 working days to incorporate your company.

INCORPORATION

Before you apply for incorporation, you should:

- **Collect company contact details** - address of registered office and email
- **Have the details of all your directors** – at least one needs to live in New Zealand, or Australia but they must be a director of an incorporated company in Australia. You need the full legal name, date and place of birth, residential address and date of appointment of each director
- **Have the details of your shares and shareholders** – personal details of each shareholder and how many shares they have
- **Declare an Ultimate Holding Company (UHC)** – In your application, disclose whether you are controlled by a UHC, what type of entity/company it is, its name, country of registration, registration number or code, if any, and registered office address
- **Upload your constitution** – Optional, but it sets out the rights, powers and duties of the company, board, directors and shareholders. There are some good reasons to consider having a constitution which we can discuss further depending on your circumstances.

When you are ready to apply for incorporation, follow the link given to you in your confirmation email from reserving your name, or log on to the Companies Register. The application fee will cost \$105 (plus GST). For more information and steps, go to the Companies Register website.

Once complete, the Companies Register will send you an email, with consent forms for the shareholders and directors to sign. These will need to be signed and returned within 20 working days.

When these are received, the Companies Register will send you a Certificate of Incorporation, and your company details will become publicly available on the Companies Register.

While you are undergoing this process, you will also need to apply for tax registration. This involves obtaining an IRD number, GST number, and you may register as an employer.

Compared to the longer process of registering a charity, setting up a company is fairly straightforward. If you have any questions about the process then feel free to contact us and we are happy to help.

Chapter 3: Key issues to watch out for in a joint venture

When considering entering into a joint venture arrangement in New Zealand with another party, it is important to be aware of potential issues before they even arise. This chapter describes some of the key points to watch out for if you are considering a joint venture in New Zealand. It can also serve as a good reminder of a checklist of points to consider to review the health of your joint venture if you are already in one.

1. VALUING DIFFERENT CONTRIBUTIONS

It can be hard to value what each party brings to the table. Typically a joint venture will be entered into because each party has recognized that the other one is able to bring some unique skill or background to a proposed business. Often for one party this may be the ability to provide capital such as finance or land while the other party has a certain expertise. Alternatively, two companies who are generally competitors may decide that working together will help them to scale up and achieve more.

Either way, the key point is not to undervalue what you bring to the joint venture. If the other party has an ingenious idea but no financing and you can unlock capital for their idea to grow, then you hold significant bargaining power. Equally, if you are the one with the industry expertise and knowledge then you should not sell yourself short in negotiations with a financier. We have seen this from both sides and often wondered why one party wasn't more highly valuing what they were bringing to the table. Sometimes there is a tendency to value tangible contributions over the intangible ones, which may not always be appropriate. So, in each case hold out for as much equity and participation in the joint venture as you reasonably can.

2. FORM OF JOINT VENTURE

Most commonly we would see a new company formed under the Companies Act 1993, which has the two joint venturers as its two shareholders. That way the new entity will be a standalone venture separate from each of them. Typically it will have its own set of advisors and employ its own staff (although one party may second certain individuals in to assist). Profits will be returned as dividends to the shareholders.

However, that is not the only option. Alternatively there could simply be a joint venture agreement between two parties which sets out how they will work together. This is called an unincorporated joint venture. There is no separate legal personality of the joint venture so it cannot contract on its own with third parties. This model may be used for financing, tax or accounting reasons.

Another possible structure is a Limited Partnership under the Limited Partnership Act 2008. This structure may be particularly attractive when one of the parties is an overseas entity or has charity status because tax liability sits at the level of the partners rather than in the corporate structure. Also the details of the limited partners are less publicly available.

It pays to work through the possible structures well in advance so you know what you want to propose to the other party.

3. OWNERSHIP SHARES AND DEADLOCK

You may think that an equal sharing in ownership is fair and that is usually correct. However, the danger of an equal split is that decisions can get stalled if the parties cannot agree and so deadlock can result. This can have a negative impact on the profits and reputation of the joint venture. There are some ways to deal with a situation of deadlock though which are outlined in the next point.

4. OVERCOMING DEADLOCK

A deadlock situation can be fatal to a joint venture. This is especially so when the shareholding is the same and there are also an equal number of directors appointed by each party. One way to deal with this is to have a rotating chairman who has the casting vote. Also, there can be a list of really key issues which are reserved as decisions for the shareholders rather than directors. All joint venture arrangements should have clear disputes resolution procedures, including, where appropriate the ability to refer matters to independent experts or umpires. Quite often though, it is usual to have a windup provision in the event of unresolvable disputes.

5. "SERVICE" ARRANGEMENTS AND EXTRACTION OF VALUE

Commonly we see that one party is the expert in the subject matter of the joint venture and so they often end up contracting to provide services to the joint venture. That is fine, but the other party should closely look at those agreements and build in clauses that ensure these will be "arms' length" arrangements.

If one party is an overseas entity they may be relying on their local partner to provide a lot of the "on the ground" work. They may not realise that the same local partner is extracting a lot of value from the arrangement with the company through charging of high consultancy services, management fees or other arrangements. Getting independent local advice is essential to get a better understanding of what terms to agree to.

6. EXITING THE JOINT VENTURE

There should be a clear pathway for getting out of the joint venture. For example, if one party wants to exit they may have to first offer their shares or interest to the other party before they can they sell to a third party. Such pre-emption rights can be included in the joint venture agreement.

What if one party wants to exit and the other party does as well? In a single company, this can be built in as "tag along" rights so that the party who is selling their shares to a third party may need to allow the other party to join in that sale. Other typical rights could include "drag along" rights where a party is able to force their joint venture partner to also sell their shares to a third party. All of these options need to be considered and worked through at the start of the joint venture. As mentioned above, provisions should also be inserted to cater for unresolvable differences avoiding the need for protracted legal disputes.

7. OTHER POINTS TO CONSIDER WHEN SETTING UP A JOINT VENTURE

The following issues should also be considered at the beginning:

- capital and funding obligations going forward;
- scope of the joint venture company;
- will it be permissible for the shareholders to enter into other joint ventures or initiatives that may compete with this joint venture?;
- business plan and budgets;
- management and who will lead the joint venture;
- ownership of land;
- circumstances that may trigger termination;
- tax implications;
- minority protection rights;
- information flow to parent companies;
- marketing arrangements;

- powers of veto;
- will there be parent company guarantees;
- confirm no competition law issues; and
- if a foreign company is involved, whether Overseas Investment Office (OIO) approvals needed.

8. NO ONE SITUATION.....

... is like the other. Many joint ventures can have more than two parties, with variable negotiating power, parties with different skills, land or finance available. It is important to tailor the documentation to the situation.

We have experience in setting up joint ventures and providing advice about different situations and would be happy to discuss your circumstances.

Chapter 4: Protecting Your IP

For many businesses, some of their most significant assets may be goodwill or other intellectual property. Parry Field Lawyers provide legal advice on a range of commercial matters including protecting your intellectual property.

WHAT IS INTELLECTUAL PROPERTY?

Intellectual property consists of a varied group of intangible property assets, such as design concepts, copyright, goodwill, trademarks and others. Some of these can be registered on a central registry, others cannot.

A business's intellectual property ("IP") will often comprise a mix of trademarks (either registered or unregistered), patents (which protect a novel concept or idea, and the application of such ideas), copyright in particular text or drawings, registered designs, business know-how, trade secrets and information such as customer lists.

HAVE YOU IDENTIFIED YOUR IP?

Your business may have a considerable amount of IP that is not being adequately safeguarded or utilised. Assets such as your trademarks, customer lists and general business know-how can be critical to the success or failure of your business by giving you the competitive edge that you need over your competitors.

If you think that you may seek investment in your business, or that you may look at selling your business in the future, be aware that any potential investor or purchaser will want to know:

- What IP the business owns;
- What steps you have taken to protect the IP; and
- How such IP will give your business the edge over your competitors.

You should take steps to identify your intellectual property and ensure it is protected. This could be as simple as having adequate confidentiality agreements in place with your staff and contractors, or may involve obtaining registration of any trademarks, designs or concepts that your business has developed. You should look at doing this sooner rather than later – once a concept is in the public domain it will not be patentable.

In this chapter, we focus on one common type of IP – the trademark. You should however, also consider and obtain advice on other types of IP, such as whether any of your inventions are patentable.

When you think of trademarks, several well-known brands will probably jump to mind. Most businesses will have a trademark or trademarks that they use in the operation of their business. It may be a name, a catchy phrase or a distinctive logo.

WHAT IS A TRADEMARK?

A trademark is a brand or sign that has distinctive qualities. It can be a name, signature, word, colour, logo or even a sound or smell. It must be capable of being represented graphically and distinguishing the goods or services of one person from that of another.

Your business may have a trademark or brand that it is using, that you have not considered obtaining protection for.

WHY REGISTER YOUR TRADEMARK?

You may consider that registration of your trademark is not relevant to your business. However, a registered trademark means that you are in a better position to enforce your rights against others who may try to use it. Registration prevents a competitor from using or obtaining rights to use a brand or distinctive name that you have developed.


A registered trademark should add to the value of your business and be an asset in any sale.

On the other side, you run the risk that your brand or even your company name may infringe that of someone else's registered trademark, so a check of the relevant register may be in order.

DON'T WAIT!

Registration may not be as costly as you think. The filing fees are not excessive and legal fees for obtaining the registration may be less than you anticipate.



To the heart of what matters.  mobile push



Chapter 5: Things you should know for your start-up

If you're new to all of this, the world of start-ups and social enterprises can be overwhelming. There can be a lot of paperwork, you don't know what you don't know, and you just want to focus all your time on your world-changing idea! To make this endeavour run as smoothly as possible for you, we've created a list of topics to consider, to give you a guiding hand.

1. BUDGET

Never undervalue the importance of research. While you may want to put all the resources you have into developing the project, you will need to factor in other associated costs and professional services. When will you start advertising? How will you do this? Will there be further development costs? Create a budget that will see your product to the Minimum Viable Product (MVP) stage, where you will then be able to start generating revenue.

2. WHERE TO PLACE YOUR MONEY

Once your budget is set, keep referring to it. You don't want to end up spending all your money on development to find you have nothing left to actually launch the product. Have certain amounts set aside for each requirement, which also ensures that your own expenses get paid!

3. WHAT ASSISTANCE CAN YOU GET?

The government can provide support by way of grants, low-cost business advice and mentoring if you are a new business. Check out the www.business.govt.nz website to see how they can help. Additionally, Callaghan Innovation can help with research and development (R&D) funding at various stages of your entrepreneurial journey. Find them at www.callaghaninnovation.govt.nz/grants. Again, research is key as these avenues can provide a lot of assistance and can ease your funding concerns.

4. FEEDBACK

While you may think your business idea is the new Uber, it is important to keep asking for and listening to feedback. It may not be necessary to change your product after every piece of advice, but reoccurring suggestions or concerns will be worth taking on board. You want your product to be financially successful, so staying in tune with your target audience, and advice from business mentors will be fundamental.

5. PROFESSIONAL HELP

In the beginning, it is unlikely that your cash flow will be abundant. While you may think it unnecessary to engage the assistance of professional advisers, the investment may be the saving of your business. Finding people to help in the areas of business strategy, marketing, legal, and financial strategy can help you prepare for the future, and understand the process.

6. LAUNCH STRATEGY

How are you going to launch your product to the public? Will you advertise beforehand? Will you do a soft launch on a test group? Are there Expos you can attend? Who do you know? Do you need business cards, banners, flyers? Can you partner with other businesses? Having a clear launch strategy will assist in the success of your MVP.

7. MARKETING

Know who your target audience is and have that lead your advertising initiatives. Having a snapchat account for your retirement village may not be the most effective use of resources. Keep in mind why you created this product, and go to those who will also be looking for a solution to the problem. Your plan doesn't have to be super complex, but having your 'why' at the front of your mind will help to direct your efforts. Make the most of networking and the sharing of resources of others.

8. TIMELINE

Especially when outsourcing a development team, it's important to have a clear timeline. Keep communicating to develop a good relationship, and work with them to stick to your allocated time frames. A good understanding and relationship with this team will be priceless as the business develops. Keep looking ahead to prepare for your next stage, and to see where you are in the big picture.

9. SEED CAPITAL RAISING

As your business develops, you will go through different stages of investment funding. Your first few rounds of capital raising will be important for creating valuable partnerships. Discuss with your strategy team who you want to make these alliances with.

10. LOOK AFTER YOURSELF

Last but not least, take the time to look after yourself. Running a start-up business can be personally consuming. Luckily there is now a big start-up community in New Zealand who can support you through the tough stages, and bounce ideas off. While you may think your only option is to run yourself into the ground, remember that the health of your business may rely on your own health and wellbeing.

Chapter 6: Operating your new business – what most people overlook

Once you've managed to set up your business, you can't stop there! What are some of the things that no one tells you about that you really need to think through, once the initial rush of starting your own business subsides? Here we outline some of the things that may trip you up and that you should be aware of.

1. BRANDING AND INTELLECTUAL PROPERTY

Before you settle on the name for the business it is important to make sure that no one else is using it – we have written an chapter on this topic at chapter 4. As well as that, be aware of who is creating your intellectual property – is it employees or contractors?

2. EMPLOYMENT

If you are employing people then there are some things you need to get just right. It pays to spend some time on making sure the employment contracts you will have with employees are robust and protect you.

3. INSURANCE

While we would love for everything to go smoothly, there are still various risks and legal issues which exist when running a start-up. It will be worth getting insurance for your endeavour, as well as factoring in the specific risks which come with your unique situation. We have a whole article devoted to this topic on our Change for Good website.

4. OCCUPATIONAL HEALTH AND SAFETY

Any health and safety requirements that come with your industry should also be ascertained. Be aware of them and have policies in place to ensure compliance. Check out [worksafe.govt.nz/managing-health-and-safety/businesses/](https://www.worksafe.govt.nz/managing-health-and-safety/businesses/) for more information. This has become one of the greatest concerns for business owners in the last few years.

5. DUE DILIGENCE

Depending on what legal structure your start-up engages, you will need to meet various governance requirements. To avoid liability further down the line, it is worthwhile to be clear of what those requirements are now, and ensure that they are being followed. This includes what records you should be

keeping, and how long you should hold on to them.

6. FUNDRAISING

Especially at the early stages, it can be tempting to get fundraising from whoever will offer it! However, it may be wise to spend time determining who you want to have as a financial stakeholder in your start up, particularly if the start-up is socially conscious.

7. PRIVACY

As privacy law will apply, it is important to consider matters of privacy. Both the information you hold about others, and the information your employees have may need to be protected in some way. The Privacy Commissioner has outlined the Information Privacy Principles at [privacy.org.nz/privacy-for-agencies/your-obligations/](https://www.privacy.org.nz/privacy-for-agencies/your-obligations/). We have also prepared a template which you can use to create your own privacy policy at our Parry Field Innovate website.

8. LEASING OR OWNING PREMISES

If you take on a lease on behalf of your start-up, the landlord may require a personal guarantee from someone obtaining a benefit from the lease. You may want to talk to us to help negotiate that position. You should also consider what insurance you will need and factor in maintenance and improvement costs.

PART B FOR PURPOSE ORGANISATIONS

Chapter 7: Company or Trust: Which one to choose for your Impact Enterprise?

This chapter examines what the most commonly used legal structures are for social enterprises in New Zealand and examines the key benefits and challenges associated with each of them.

One of the most confusing aspects about setting up a social enterprise is getting the legal structure right. You might have thought the hard work was done when you had the great idea with the hope of becoming a self-funding business that also achieves good in the community. In fact that is just the beginning of the journey because you also need to find the right type of entity (separate to you as an individual) which can move the idea forward.

In New Zealand there is currently no legal structure which is specifically aimed at being a vehicle that social enterprises can use with confidence. For now, we need to make do with the legal structures which are available. In our view, the two most common are setting up as a company, or setting up as a trust. This chapter looks at both of those options.

One of the key points to consider before we look at the detail of each option is to remember that you need to "tell your story" in a compelling way to future investors, funders and the community. Choosing the right structure is therefore really important because that becomes a fundamental part of that story. Will it be easy to explain to funders who offer grants that you have a company structure and are the sole shareholder? Probably not. If you want investors who are seeking returns on their investment, how will they respond when they learn that you have set up as a trust? You get the idea. So thinking through who your story needs to be told to will be important when thinking through the structure that is most appropriate.

WHY SET UP AS A COMPANY?

A company structure offers a model which is well known and is easily explained. We see this used quite a lot in New Zealand, not just in "for profit" scenarios. The word "limited" at the end of all company names in New Zealand is there for a reason – incorporating as a company is an effective way of limiting and containing liability that the entity may incur. That provides comfort for shareholders who will not be personally liable if the venture does not succeed. The contrast with trying to run a social enterprise in your personal name should be obvious - in that situation you have 100% control but could also be personally liable for debts that are incurred.

One of the other main advantages of this structure relates to governance. The founders who had the great idea can also be the shareholders and therefore retain control over the direction of the company. The company will have a board made up of at least one director and they are usually appointed by the shareholders which again offers another level of control to those who founded the company.

One of the downsides of setting up as a company has been hinted at earlier: people assume that a company structure is being used because there is a desire to make a profit. If your strategy is to approach foundations or other groups who might provide large scale funding for your idea then that can make it tough to explain. One of the ways to deal with this is to try and hard wire your purpose into the company structure itself by stating clearly in the founding document (in the case of the company, the Constitution) what the purpose of the company will be. This will be essential if you decide to apply for registration of the company as a charity with Charities Services because they will look at the purposes which are set out there to decide if your entity meets the criteria to be registered as a charity. For more on these issues see Chapter 9.

WHY SET UP AS A TRUST?

Setting up a trust is probably the most common form of entity used for not-for-profit enterprises in New Zealand. It is a structure which is easily explained and because there are no "shareholders" as such it provides a clean story to explain to people. There is something of an inbuilt assumption that if you are a trust then it is automatically assumed that this is a "for good" type of entity. This is in contrast to the company structure where there can be an assumption that there is a "for profit" element as a main objective.

A trust does not have shareholders and is instead guided by trustees who form a Board, when incorporated under the Charitable Trusts Act 1957. In some ways this might be seen as providing less control to the original founders. However, in practice the founders will choose trustees who share the vision for the trust so that they can ensure it follows in the direction intended. One of the key decisions at an early stage is how to make decisions about replacement trustees - will they be shoulder tapped by current trustees, elected or some combination of both those options? Governance issues will sooner or later become a key point for the trust so it is best to get this sorted early, by having clear provisions in the Trust Deed, the founding document for a trust.

The purpose is also safeguarded by the Trust Deed, which will have a "purposes" section that sets those out clearly. It is really important to make sure that the purposes decided on accurately reflect what the trust is intended for. As with a company structure if you go to Charities Services this will be really important when they decide to register you as a charity (or not). One of the weaknesses we see is that people do not define the purpose using terminology and ways of describing what they will do so that they fit within one of the four recognised charitable purposes under New Zealand law.

WHAT ABOUT TWO FOR ONE?

As can be seen, each of the most commonly used structures have both pluses and minuses. One option we have seen people do is to set up using both structures to try and get the unique advantages that each provide. In that scenario, there is usually a trust which has been registered as a charity and has donee tax status. When telling the story to funders and donors it is a structure that can be easily explained and they can get on board with.

At the same time the trust may have a trading arm which is set up as a company. Usually the shareholder will be the charitable trust. The income that is generated by the business of that company will go back to the trust for it to continue carrying on its charitable purposes. But having the company may provide more flexibility such as a vehicle to enter into joint ventures with other entities or seek other investors into the company. Like most structuring it is important to get good accounting advice on some of the tax and accounting implications of setting up in this way.

CONCLUSION

We hope that this overview of the two main options for social enterprises in New Zealand has provided some clarity over why each structure might be used. Ultimately it would be great if there could be a new form of entity which took the best aspects of both the company and trust structures and that could be used going forward. For now though, we need to make do with what is available and adapt the structures that we can use in order to further advance social enterprises in New Zealand.

Chapter 8: Governance Structures for Trusts

Once you have decided that you want to be a Trustee rather than a company, one theme that often comes up for charities, not-for-profits and social enterprises relates to how the organisation will be governed. This same issue applies whether the particular involvement is in education, relief of poverty, youth work, the arts or some other worthy cause. Governance structures are of critical importance.

Different organisations have different approaches to governance and the appointment of those in charge. Below we have described some of the options which are available when considering how to structure a board or governance body.

These represent what we consider to be the most commonly used methods for governance as well as the pros and cons of each for you to consider. Obviously this is an overview document so there are many factors to think through, but we hope this will provide a good sense of the options.

GOVERNANCE STRUCTURES OPTION 1: TRUSTEES APPOINT TRUSTEES

Overview: When a vacancy or specific need becomes apparent, the Trust identifies a possible trustee and a working relationship is begun. The Board appoints trustees to fill vacancies or as additional trustees. This is then approved at the next trustee meeting. Often there are provisions that at each anniversary, a percentage of Trustees are to retire (longest serving first).

It is fairly common for Charitable Trusts to have an appointment process like this that gives the power of appointment to the current trustees but gives a veto right to another defined group.

Positive:

- Trustees retain control over who is approached.
- Board can appoint trustees directly.
- If they choose to do so, an AGM can be involved in process so two levels of approval are required.

Negative:

- Process not always followed well, creating possible irregularity in the appointment of trustees.
- Less involvement of wider community.
- Potential for incoming trustees to shift the focus of the Trust over time without any control mechanism to preserve original vision.

GOVERNANCE STRUCTURES OPTION 2: TRUSTEE ELECTIONS

Overview: Election of Trustees at each AGM so the public calls for nominations before that. We have seen this mainly with school trust boards.

Positive:

- Wider community involvement in process.
- Greater potential pool of trustees with diverse experience.

Negative:

- Uncertainty as to background of potential candidates and understanding of special character.
- External engagement required e.g. advertising vacancies.

GOVERNANCE STRUCTURES OPTION 3: HYBRID MODEL

Overview: Provide for election of some Trustees from certain backgrounds e.g. one Trustee appointed by associates body. Others to be appointed by combination of above e.g. election / Trustees choose who to appoint.

Positive:

- Incorporates elements that are positive in above examples e.g. diversity, involvement in process, ability to choose some trustees.
- Has more checks and balances.

Negative:

- More complex appointment process may be harder to administer.
- Some voters may not have a strong connection with any special character.

REFLECTIONS ON THESE OPTIONS

In our experience the most common structure is for the existing trustees to have the power to appoint replacement trustees. The simplicity of this approach is one of the key reasons for its popularity.

In some cases, the trustees' power of appointment is subject to a right of veto granted in favour of the group or entity that originally established the Charitable Trust. This is a viable approach and reduces the risk that the incoming trustees may over time shift the focus of the Trust.

Having elected trustees is more akin to an Incorporated Society model where members of the society elect Board members from time to time. The main negative of this approach is the complexity it adds to the appointment process. If notice deadlines are missed by the trustees, irregularities will arise in the appointment of trustees.

In considering which approach to adopt, the trustees should also take into account the different roles a Trust performs – governance vs administration/upkeep of properties etc.

Every situation is unique. We hope this short summary of some common options is helpful and would be happy to discuss any of them with you in more detail than can be contained in this overview.



Chapter 9: Setting up a Charitable Trust and Key Points to Consider

So you have a great idea that just might make a difference in the world, but are wondering about how to formalise a legal structure that would help you do that? A charitable trust is one of the most commonly used options in New Zealand. This chapter describes the steps to set up a charitable trust and key points to consider.

ADVANTAGES OF A CHARITABLE TRUST

A charitable trust can provide a number of advantages. For example:

- **Reputation:** Funders and donors tend to gain comfort if the entity is a charitable trust (rather than a private business or individual). Where a company sets up a charitable trust and invites staff to participate, they will be motivated by the charitable purposes.
- **Tax status:** There can be tax advantages in registering as a charitable trust with Charities Services (see below).
- **Longevity:** A trust is not dependent on one individual and can go on long after the founder ceases to be involved, in “perpetuity” in fact.

Great examples of charitable trusts in New Zealand include World Vision, The New Zealand Breast Cancer Foundation, and Ronald McDonald House.

KEY POINTS BEFORE SETTING UP

To set up a charitable trust you will need a founding document for the Trust – called a Trust Deed. This is the legal document which sets out the key elements of the Trust. The questions you should answer before you see your lawyer are as follows:

- **What are your purposes:** A charitable trust must be charitable. That may sound basic but it isn’t necessarily as easy as having a good idea – for example, if you want to develop a new type of transport that is safer than a car then it sounds great but by itself that purpose won’t be “charitable”. You need to fall within one of the following categories to count as a charity:
- **Alleviate poverty:** This does not just apply to the destitute but could be for those that fall below the ordinary standard of living. It could be achieved through financial means but also through practical means such as providing food and shelter;

- **Promote education:** Whether something is deemed to be charitable under this category will depend on its usefulness and its educational value;
- **Promote religion:** This is about the promotion of a wide range of spiritual teachings. Charitable purposes under this heading could range from the provision and maintenance of ministers/religious leaders to the provision of buildings for worship. However, it does not include just the promotion of certain ethics;
- **Other charitable purposes beneficial to the community:** This in a way is a “catch-all” provision. It can include such purposes as the promotion of health and recreational facilities. However, a trust will not be deemed charitable under this category if it is not for some public benefit.

Whether your purposes will fit the definitions is something that we can discuss with you.

OTHER QUESTIONS TO ANSWER

Are political purposes okay?

One of the historical fundamental requirements of charitable trusts was that they were not underpinned by some political purpose. However, as of 2014, the New Zealand Courts have found that if a charitable trust has an ancillary (secondary) purpose that is political in nature, then that does not automatically exclude the trust from being charitable if there is still some public benefit. What is important to remember is that this political purpose must be secondary to the main charitable purpose and whether or not the trust is deemed charitable will be decided on a case by case basis.

What will your activities be?

Once you have purposes it is important to think about the practical side of how you will implement those purposes. Will that involve running seminars and workshops? Providing scholarships? Promoting participation by volunteers? Jot down all your ideas so they can be incorporated in the Trust Deed.

What will the trust’s name be?

Usually charitable trusts will have a name that reflects their charitable purposes or what they aim to achieve. However, before finalising a name you have to be certain that your trust will be able to use that name. The name cannot be the same or similar to the name of another charitable trust or any other corporate body. If you do decide to use a name similar to that of another trust or corporate then you may need to have the written consent of that trust or corporate to use it.

Who will the trustees be?

The trustees are those who meet and guide the Trust in the future. They can also be great ambassadors for the cause. Choose them wisely and consider having a variety of people involved who bring different skills. For example, a charity focused on education of young people should try to have teachers involved, but also those with other skills.

Incorporation.

Trustees can apply to the Registrar at the NZ Companies Office for incorporation as a board. The benefits of doing this include:

- The Trust becomes a separate legal entity with separate legal liability. This generally means that the trustees are not personally liable for the legal commitments of the Trust.
- If the Trust owns real estate or other registered assets, it does not need to update the title or ownership register every time the trustees change.

Tax status. If you want to have the benefit of a tax exemption and the ability to issue charitable receipts for donations, you will need to register your charitable trust with NZ Charities Services.

PRACTICAL CONSIDERATIONS, COST AND TIMING INVOLVED

Before you start the process it is worth knowing a few practical points -

- **Writing the Trust Deed** – particularly the charitable purposes, can take a few weeks to get all trustees to agree upon. Important issues such as the statement of purposes, who hold the power to appoint and remove trustees, need to be decided before the trust deed is signed.
- **Time frames involved to achieve registration** – a few days for Companies Office, a few weeks/months for Charities Services.
- **Registering with the Registrar of Societies and Trusts at the Companies Office** – this is a free application which must be signed by all trustees. In addition one trustee must sign a statutory declaration in support of the application and attach a certified copy of the trust deed.
- **Time frames for incorporation** – 1-2 days once application documentation signed.
- **Registering with the Charities Office** – this is a free online application on the Charities Services website.

- **Application requirements** – the application form is reasonably detailed. It must be accompanied by a statutory declaration from one of the trustee applicants. Charities Services, when considering your application, will want to see good evidence of the Trust's existing or intended charitable activities so that it can satisfy itself the actual activities are genuinely charitable.
- **Time frames for registration** – this can take up to three months from the time Charities Services receive application.
- **Time frame for tax exempt status** – Charities Services should notify IRD directly once your charitable registration is approved, but it can take a few weeks for your trust to show up on the IRD's list of donee organisations.
- **The availability of trustees to sign documents** – this can depend on where your trustees are. Scanning and emailing do make the process easier, but trustees ought to meet at least once during the process.

CONCLUSION

Although setting up a charitable trust can take time, it is often a most worthwhile structure to have in place. We have helped many charities over the years and would be happy to discuss your situation with you.

PART C FUNDRAISING

Chapter 10: Raising funds from Family and Friends

If you have a start-up one of the first things you need to find is money to fund the research and development of your new idea.

Rather than turning to a bank, sometimes founders look instead to their friends and family for financial contributions. What are some of the key things to think about if you want to go down that route and seek contributions from them?

1. WILL THIS RUIN THE RELATIONSHIP?

The first point is not a legal consideration as such - more of a home grown truth: money has a unique way of affecting relationships (often in a bad way). You may think your relationships are above this and of course there is 100% certainty your new idea will be the next Facebook. But if whatever your friend or family member invested was lost how would this impact that relationship?

If you can foresee that there could be hard feelings and resentment then you need to seriously weigh up if it is worth risking that relationship.

2. WHAT CONTRIBUTION WILL THEY MAKE?

Second, think about what form the contribution will take. Will you be seeking loans from people with a fixed end date and payment of interest? Or do you actually want to bring people on board as shareholders in the company and involve them in the future success that you will hopefully enjoy?

Most people who are approached will realise it is a risky business but want more upside than just some interest on a loan. What will fit best for you and the future of your company?

3. HOW INVOLVED WILL THEY BE?

Third, consider what level of say each person will have in the decision making for the company. How involved will these people be in the decision making or are they simply silent investors with limited rights? These points should be clearly agreed and documented. This is usually done in a shareholders' agreement.

4. DO I NEED TO COMPLY WITH THE FINANCIAL MARKETS CONDUCT ACT?

Fourth, understand the rules relating to fundraising and what exclusions might apply - some of these are outlined below. The Financial Markets Conduct Act 2013 is very long and detailed but the basic policy approach is that you will be caught by it and need to provide disclosure of information to investors unless there is an exemption for what you want to do.

What are the key exclusions that might apply?

Some of the most relevant exemptions in the context being discussed in this chapter would be:

Close business associates

Offers to people who already know the business are subject to an exclusion because they would be unlikely to need full disclosure before making an informed decision about whether to invest or not. They need to be able to assess the merits of the offer and obtain information from the person making the offer.

Whether a person actually is a close business associate will need to be assessed on the facts, but the term is defined to include situations such as the person being a director or senior manager of the company, holding 5% or more of the votes of the company, is a spouse, partner or de facto partner of a person who is a close business associate. These are just some examples to show the nature of the relationships caught.

RELATIVES

Along similar lines to the last exclusion, offers can be made to relatives. They are defined to include the following: A spouse, civil union partner, de facto partner, grandparent, parent, child, grandchild, brother, sister, nephew, niece, uncle, aunt, first cousin. The list also includes spouses, partners and de facto partners of those people listed as well as whether or not they result from a step relationship or not. Also included are trustees of a trust where one of the above is a beneficiary.

We had an interesting example where a person said that their Godfather wanted to invest. There was a close relationship, but they were not a “relative” under this definition. So you need to avoid making assumptions that someone is a relative, and make sure they fit the definition.

SMALL OFFERS

A small offer must be for debt or equity securities and for up to a maximum of 20 investors and raising a maximum of \$2 million in any 12 month period.

Such offers need to be a “personal offer” which can only be made to certain individuals, such as those who are likely to be interested in the offer (e.g. some previous connection and interest known), a person with a high annual gross income (at least \$200k in each of last two income years) or someone who is controlled by such a person.

SOME OTHER KEY POINTS:

- Small offers also have an advertising prohibition so it is important to check what you do to ‘get the word out’ is not going to breach that requirement.
- Notification is required of certain information about the offer to the FMA within one month of the end of the relevant accounting period that the small offer was made.
- A warning needs to go on the front of documents which looks like this:

“Warning

You are being offered [name of financial product type (for example, ordinary shares)] in [name of issuer].

New Zealand law normally requires people who offer financial products to give information to investors before they invest. This requires those offering financial products to have disclosed information that is important for investors to make an informed decision.

The usual rules do not apply to this offer because it is a small offer. As a result, you may not be given all the information usually required. You will also have fewer other legal protections for this investment.

Ask questions, read all documents carefully, and seek independent financial advice before committing yourself.”

OTHER EXCLUSIONS

This chapter has been focused on investments by family and friends so has not looked at every possible exclusion. However, for more detail on other exclusions have a look at the FMA site.

Chapter 11: Crowdfunding: An increasingly viable option for start-ups?

An option for raising funds is crowdfunding – using this exemption, you will have to work with an FMA licenced intermediary to raise the funds. The licenced intermediary will offer your equity, debt or other financial products to investors for you. You can use the crowdfunding exception in combination with other exclusions (such as the wholesale investor exclusion above and others which we touch on [here](#)), but there is a limit of \$2 million in any 12-month period (which includes any ‘small offers’ in that time period).

At the end of 2017, the Financial Markets Authority released the first statistics relating to crowdfunding in New Zealand. It shows that beyond any doubt this is an option for people to consider in order to raise funds for their new venture. A compelling story and provable business case is all that may be necessary to raise the amounts needed to take a business to the next level.

Some of the key highlights that stood out to us are:

- A total of \$74.2 million in total was raised by investor crowdfunding;
- In relation to peer to peer lending there are 7 such entities registered and in the year ending 30 June 2017:
 - a) \$259.9 million is currently loaned to individuals; and
 - b) \$29.5 million loaned to businesses.
- Interestingly, the average value for new loans was just \$8,771.

In relation to crowdfunding it is worth quoting the relevant part with the key statistics: “Of the eight licenced crowdfunding providers, 5 facilitated offers during the reporting period. There were a total of 50 offers, with 34 successfully meeting their funding target. 263 potential issuers were declined. 1,597 investors invested in crowdfunding for the first time, with 2,331 investing through the crowdfunding system in the year.”

That picture is consistent with recent examples we have seen i.e. *Cultivate Christchurch* with their “Broccoli Bonds” and *Kilmarnock Enterprises* with their crowdfunding campaign.

If you are looking to raise money for your venture then it is worth considering these options. Keep in mind as well the restrictions on seeking funding from others.

Chapter 12: What is a ‘Wholesale Investor’?

When fundraising you can avoid a lot of regulations if you approach wholesale investors – so who they are and how do you make sure you are sure?

Companies need money, it is the fuel for the engine of their growth. Very often they will get that money through issuing equity (shares to people who invest) or issuing debt (loans to people who provide finance). If you do either of these activities you are offering a financial product and captured by the Financial Markets Authority and their rules which state you need to provide extensive disclosure documentation to those investing – unless an exemption applies.

In this article we want to talk about two critical exemptions which we see are commonly used.

A wholesale investor is essentially a person or an organisation with enough previous investing experience that they do not require disclosure documentation. Their experience is often shown by their investment activity, wealth and/or income. Wholesale investors can be exempted for all offers of financial products or only for some offers of financial products and the critical points to consider if you want to rely on this exemption are:

- Is the investor an investment business, such as a financial adviser or a licenced insurer
- Has the investor recently held or acquired financial products of aggregate value of over \$1 million
- What is the investor’s wealth – do their net assets exceed \$5 million
- Is the investor able and willing to certify that they are sufficiently experienced with the particular financial product you are offering
- Is the investor subscribing for at least \$750,000 worth of financial product

The FMA has provided a helpful overview of various options and exemptions which you can access [here](#).

We have helped many companies with their capital raising and each situation is unique so feel free to reach out if you would like specific input on your context.

To the heart of what matters.



PART D LIABILITY AND ONGOING DUTIES

Chapter 13: Duties and Liabilities Imposed on a Director of a New Zealand Company

New Zealand's Companies Act 1993 and common law impose duties and liabilities on the directors of a company.

WHO IS A DIRECTOR?

Many of the following duties are not limited to those actually on the board of directors. A director can also include "shadow directors" who instruct the directors how to act, and persons who exercise powers of the board by delegation.

WHO ARE DUTIES OWED TO?

In general, these duties are owed directly to the company, giving it the right to sue a director for breach of duty (and not individual shareholders or creditors). However, there does exist a number of provisions by which shareholders and creditors may pursue directors - these will be examined at the end of this section.

1. DUTY TO ACT IN GOOD FAITH AND IN THE BEST INTERESTS OF THE COMPANY (S131)

Good Faith

Good faith implies acting with a proper motive - without any malice or dishonesty. It also means avoiding acts which promote a director's own interests at the expense of the company's (historically termed "conflicts of interest").

Acting in the best interests of the company

This is a subjective test - that is, directors must only act in what they perceive to be the best interests of the company - not what an "ordinary" or "reasonable" director might do. This gives directors a certain amount of discretion to use their own business judgment, without fear of every decision being vulnerable to scrutiny.

Exceptions to best interests rule

If the company is a joint venture company or a wholly owned subsidiary of a parent company, a director may act in the best interests of his or her appointing shareholder or parent company even if this is not in the company's best interests. This recognises that these are unique entities - whose operation is dependent upon directors having a free rein to carry out the intention of their (often conflicting) shareholders.

Strait-jacketed?

Given the duty to avoid conflicts of interest, can directors have any interest in a transaction or use any information gained by virtue of their position? The short answer is "yes" - provided they are willing to jump through the fairly arduous hoops of disclosure imposed by the 1993 Act - these will be discussed shortly.

Our Advice

Don't get too comfortable with the notion that as long as you believe a decision is in the best interests of the company, you'll be fine. If your decision is one which any director with any appreciation of fiduciary responsibilities would see as being inconceivable, it is likely a Court would view this as a breach of section 131 - despite its subjective appearance. There is also an independent duty on directors to exercise reasonable care and skill - read on....

2. DUTY TO EXERCISE POWERS FOR A PROPER PURPOSE (S133)

At its simplest, this duty could be said to cover the situation where a director strays beyond the limitations intended for their office and acts out of an ulterior motive. Unfortunately, it seems impossible to define in advance exactly what situations fall within this definition. It may be that it is not until a Court reviews the exercise of a power that it can be determined whether or not that power was exercised for a proper purpose.

Our Advice

Be aware that this duty is not related to the duty to act in good faith - that is, a director could act in what he or she thought was the best interests of the company, but still be acting for an improper purpose. A clear example of this would be the directors issuing shares solely for the purpose of diluting a particular (and probably troublesome) shareholder's shareholding. While this may be in the best interests of the company as a whole (and even applauded by the other shareholders), it will nevertheless be an improper motive for issuing shares.

3. DUTY TO COMPLY WITH COMPANIES ACT 1993 AND COMPANY CONSTITUTION (S134)

It is obvious that by not complying with the Act or the Company Constitution, a director would be acting outside of his or her mandate.

But wait, there's more...

However, this duty may be more onerous than it first appears. The Act imposes numerous responsibilities on directors, of which failure to discharge may result in criminal liability (discussed later). For example, under section 87(1), a share register must be maintained by the company. Failure to do this would mean that the Act is not being complied with and, for a director, would be a breach of the section 134 duty. This breach will be actionable by the company as against the director, which means that not only does so simple an omission as failure to maintain a share register constitute a criminal offence, it exposes directors to potential civil liability for breach of s.134.

Our Advice

Make sure you are also aware of obligations under other statutes, such as the Privacy Act, Health & Safety in Employment Act, Resource Management Act... - because if you cause the company to act in contravention of any statute, this would almost certainly amount to acting for an improper purpose or not acting in the best interests of the company.

4. RECKLESS TRADING (S135) DON'T BE SO RECKLESS...

A director must not agree to, cause or allow the business of the company to be carried on in a manner likely to create a substantial risk of serious loss to the company's creditors. This duty is aimed at preventing conduct by the directors which could jeopardise the company's solvency. It is not designed to curtail the directors' ability to take risks - as long as the company is well able to bear the loss from complete failure.

Objective Test

Unlike the best interests duty, the directors personal opinion as to the company's ability to continue trading is irrelevant, and a Court is likely to ask: "Was there something in the financial position of the company which would have alerted an ordinary prudent director to the real possibility that continuing to carry on the business of the company would cause serious loss to the creditors?"

Arise from your slumber

The situation of a director who "allows" reckless trading may include the "sleeping director" who has little or no actual knowledge of the company business, but is content to abdicate his or her responsibilities to more active members of the board.

Our Advice

Make sure you have a reasonable knowledge of goings on no matter what your level of involvement in the company. If you miss a board meeting, make sure you find out what happened from another director - even obtain a copy of the minutes to ensure no major decision was made - which you might have "allowed" by your absence.

5. DUTY IN RELATION TO OBLIGATIONS (S136)

A director must not agree to the company incurring an obligation unless he or she believes on reasonable grounds when the obligation is incurred that the company will be able to perform the obligation when required to do so.

This will apply to such transactions as the company giving a guarantee.

Cramping their style?

It has been suggested that this duty will prevent directors taking commercial risks. However, as long as the directors' decision is based on reasonable inquiries, research or information, it is less likely to be scrutinised later.

Our Advice

When making a decision of this kind, the board should leave a "paper trail" - detailing not only their decision, but also their reasons. Better still, obtain professional advice. This will go towards showing that you acted on "reasonable grounds". Also, do your homework early on - note the test is applied "at the time the obligation is incurred" - that is, when the transaction is entered.

6. DIRECTOR'S DUTY OF CARE & SKILL (S137) THE TEST

Directors are required, when exercising powers or performing duties, to exercise the care, diligence and skill that a reasonable director would exercise in the same circumstances, taking into account:

- the nature of the company
- the nature of the decision;
- the position of the director; and
- the nature of responsibilities undertaken by him/her

Therefore, it seems each director is judged on his or her role in each decision made. If a director is appointed to a specific task, he or she may be liable if they do not bring the required skills to that task. However, it appears that a director is not ordinarily supposed to have special skills - so there may be differing levels of skill and care expected from executive and non-executive directors (but note that any difference between these directors applies to this duty only).

Don't go down these roads...

Examples of the Courts finding directors to have breached this duty include:

- where they acted before becoming fully acquainted with the company's affairs.
- where loans were made to a company connected to a director with no possible benefit to the company.
- where cheques were signed in blank and the conduct of the business left entirely to another director.
- where directors unquestionably trusted (subsequently dishonest) employees with the management of the company.

A Higher Standard?

Many people believe that this duty places a greater burden and more stringent standard of care on directors than was previously the case. At the very least, it would seem that shareholder's greater awareness of a statutory duty of care on directors will lead to higher expectations and increased vigilance of directors' actions.

Our Advice

It's vital to understand that it's no longer acceptable to sit back and let others run the show. It is clearly established that even directors who are scarcely involved in management of the company can still be held liable when financial difficulties sprout. Evaluate your position as a director - are you familiar with the ins and outs of the business? Do you read (and understand) the financial accounts? Do you attend board meetings? Do you have a hand in business decision-making? If the answer to these is generally "No", it may well be that you shouldn't be a director at all!

7. USE OF INFORMATION AND ADVICE (S138) RELIEF FROM OMNISCIENCE?

In today's commercial environment, directors cannot be expected to know everything about their company, or possess all the skills necessary for business decision making (although based on the foregoing, you could be forgiven for thinking otherwise!) Section 138 provides a (limited) form of relief for directors. It entitles directors, in the course of decision making, to rely upon reports, statements and financial data, as well as professional/expert advice given to them by:

- an employee of the company who is believed by the director (reasonably) to be reliable and competent in the matters concerned - this could be another director.
- a professional adviser/expert on matters within their competence.

There is a catch...But: in doing so, directors must act in good faith, make proper inquiry where the circumstances indicate a need for this, and have no knowledge that their reliance on the information is unreasonable.

Our Advice

Again, documentation of decisions is the key - whenever you rely on someone else's advice, record that fact. And don't just blindly rely on others - as a director, you should be capable of reaching a reasonably informed opinion of the company's financial capacity. If there are grounds of suspicion arising from another's advice - act appropriately.

8. DIRECTOR'S INTERESTS (SS139-144)

Traditionally, if a director had an interest in a contract made with the company, he or she had to account to the company for any profits they might make (unless the company's Articles or shareholders permitted otherwise). This was seen as an unduly harsh rule, and has now given way to a more permissive - but also more controlled - regime under the disclosure provisions of the Companies Act 1993.

Cards on the Table

While the nuts and bolts of disclosure will be discussed in the section on Company Registers, the gist of these sections is that where a director has (or may obtain) a direct or indirect financial benefit in a transaction, he or she must disclose their interest in the transaction as soon as they become aware of it.

Disclosure is made by way of entry in the interests register, which must be kept by the Company. Disclosure is also required to be made to the board.

Avoidance by the Company

A transaction in which a director is interested may be avoided by the company anytime within three months after the transaction is disclosed to the shareholders (whether by annual report or otherwise) - unless it is proved that the transaction is for fair value.

Our Advice

Err on the side of excess when it comes to disclosure. While failure to disclose an interest in the register doesn't affect the transaction's validity, it could open you up to a \$10,000 fine or an action from shareholders for breach of duty.

Also, disclose interests to the shareholders early - don't leave it until the annual report - this could be months away and extend the time the transaction can be turned over by the company.

9. USE OF COMPANY INFORMATION (S.145) PSSST!. (DON'T) PASS IT ON!

As with director's interests, directors have traditionally been prohibited from using company property (including confidential information and trade secrets) for their own purposes. However, once again this blanket prohibition seems to have been abandoned in favour of regulating the use of information by directors.

Section 145 of the Act provides that a director who possesses confidential information must not disclose that information to any person, nor make use of it or act on it, subject to the following exceptions:

- If disclosure is made solely for company purposes.
- If disclosure is required by law.
- If:
 - (a) the director has entered particulars of the disclosure in the interests register; and
 - (b) the board has authorised the director to make disclosure; and
 - (c) the disclosure will not prejudice the company.
- If disclosure is made by a nominee director to his or her appointer, provided this is not prohibited by the Board.

What is confidential information?

It could be anything, but definitely includes trade secrets, technical know-how, lists of customers, internal financial reports, feasibility studies, and specific information concerning ongoing transactions between the company and its clients.

It is important to note that the section does not directly cover the use of company information by a former director. Here, the company would probably need to rely on the common law relating to breach of confidence.

Our Advice

While s145 would seem to provide reasonable protection, if your company's operation is such that directors are often privy to large amounts of confidential information and/or have outside interests in similar spheres, it may be prudent to have the directors sign a confidentiality/restraint of trade agreement which expressly binds them during and beyond their term of office.

10. FURTHER LIABILITY

While the above synopsis sets out the primary duties a director must uphold (which, in essence, place the quality and integrity of their decisions under the spotlight), liability for breach of these duties is by no means the only way a director can be called to account. What follows is a whistle-stop tour (or steeple-chase) of further provisions of the Companies Act 1993 which could cause a director to stumble:

- A director owes duties directly to shareholders to supervise the share register, disclose interests in contracts with the company (as discussed above), and disclose any interest they have in share dealings. A breach of these duties entitles a shareholder to bring a personal action against a director (s169).
- A shareholder could also bring an action to either restrain a director from acting in a manner which breaches the Act or the company constitution (s164), or to force them to act in accordance with these (s170).
- Directors may be personally liable if a distribution is made to shareholders when the company is insolvent - to the extent that the distribution is not able to be recovered from the shareholders (s56).
- Directors may be personally liable to liquidators or creditors for the debts of the company if they participate in the management of a company when they have been disqualified (by the Court or the Registrar) from doing so (ss384, 386).
- Directors may be liable to the company if they receive an unauthorised payment or have unauthorised insurance effected - to the extent they are unable to prove these are fair to the company (ss161, 162).
- If, on the liquidation of the company, it appears to the Court that a director has misapplied company money or property, or has been guilty of negligence, default or breach of trust, he or she may be liable to repay or restore the money or property, or contribute an amount to the assets of the company by way of compensation (s301). Note that a creditor is entitled to apply for an order under this section and could allege breach of any duty as grounds for an order that money or property be paid directly to the creditor. If a company is in liquidation and the failure by the company to keep proper accounting records has contributed to its inability to pay its debts or impedes an orderly liquidation, a Court can order that any directors or former directors are personally responsible for all or any part of the debts of the company - unless they can show they took reasonable steps to ensure compliance (s300).
- Criminal Liability: There are over 100 sections of the Act of which a breach can constitute a criminal offence. In almost all of these sections, criminal liability is imposed on the directors personally, in addition to the company (there do exist limited defences relating to reasonableness on the part of directors). Penalties can be up to \$5,000 or \$10,000 - depending on the offence. Far more serious, dishonesty offences can carry up to 5 years imprisonment or a fine of \$200,000 (ss373, 374).
- Liability in tort: A director can be liable for a tort (for example, negligence) committed primarily by the company, but through their agency - if they have somehow assumed personal responsibility for their actions.
- A director who trades shares using inside information is liable to account to the buyer to the extent that the shares are sold for more or less than their fair value (s149).
- Directors should also be aware of both the company's and their own obligations under any other legislation - which also have the potential to fix personal liability on directors. These include, but are not limited to the Financial Reporting Act, Fair Trading Act, Health & Safety at Work Act, Resource Management Act, Commerce Act, Privacy Act, Human Rights Act, and Building Act.

CONCLUSION

It will hopefully be apparent by now that the significance and potential consequences of these duties and liabilities are not to be sneezed at. Unfortunately, it seems that at present directors are either largely ignorant of these standards or do not take them sufficiently seriously. Perhaps more unfortunate is that it is usually not until a company fails that the ambit of these duties becomes relevant - when a director's decision is reviewed by the Court.

It is imperative to get things right at the time each decision is made. If you have any doubt as to the wisdom of any decision or act either of your own or your fellow directors, seek legal advice.

It is also important to note that many of these duties are new provisions - whose exact scope cannot be ascertained with real certainty. Don't let your actions be the subject of a test case!

Because the implications of these duties are potentially severe, companies are increasingly availing themselves of the indemnity and insurance provisions of the 1993 Act (details of which are discussed in the Company Registers section) as part of a risk management strategy designed to avoid personal liability on the part of directors.

Chapter 14: Thinking Of Paying Yourself Director's Fees?

If you are a director of a small or medium sized company, you may be faced with the question of determining what is a reasonable and acceptable level of remuneration for yourself as a director. Parry Field Lawyers provide legal advice for managing your company including payment of directors' fees.

WHAT COUNTS AS DIRECTORS' FEES?

Remuneration can take many forms e.g. paying a director a fee in the form of cash, requiring the company to give a guarantee for the director's borrowings or by the company lending money directly to the director.

WHEN CAN I PAY OUT DIRECTOR'S FEES?

The Companies Act 1993 ("the Act") places a restriction on the payment of remuneration or other benefits to a director. All the directors must certify that the remuneration is fair to the company and that they have reasonable grounds for that view.

Where the procedures in the Act are not followed, or if there are no grounds for the view that the proposal is fair to the company, each director is personally liable to the company if he or she cannot prove fairness.

The Act does not provide any further guidance as to what is fair remuneration for a director. Fortunately, the New Zealand Institute of Directors has published "Guidelines for Non- Executive Director Remuneration" which sets out guidelines to achieving a reasonable and acceptable level of remuneration for directors.

These guidelines may be purchased online from the Institute's website: www.iod.org.nz.

Directors who are concerned that their levels of remuneration may not be fair would do well to seek advice and help.

Chapter 15: Shareholders' Rights and Powers

Most businesses in New Zealand are small, closely held companies. Often, their directors and shareholders are the same and they also work for the business. This means the lines between acting as director, shareholder, or manager get very blurred.

The Companies Act 1993 imposes a number of obligations on shareholders to ensure that directors/ shareholders act appropriately in their different roles. Parry Field Lawyers provide legal advice on a range of commercial matters including company management and the rights and obligations of shareholders.

SHAREHOLDERS HOLD THE POWER BEHIND THE THRONE

The directors of a company make the day to day decisions. Section 104 of the Companies Act 1993 ("the Act") restricts shareholder power, and the exercising of it, to the annual meetings and special meetings of shareholders (or a resolution in place of an actual meeting, which is often the preferred option). It must be remembered that a director may be linked to another entity which is a shareholder in the company, such as where a director is a trustee and/or beneficiary of a family trust, holding shares in the company. In that situation, the role of independent trustees in those trusts becomes important in ensuring that the interests of the shareholders are met and that the shareholders do not simply rubber stamp the director's wishes.

SHAREHOLDER POWER

The Act prescribes that certain powers must be exercised only by the shareholders of a company. These powers include adopting, altering or revoking a constitution (s32), altering shareholder rights (s119), approving a major financial transaction (s129), appointing and removing directors (s153), approving an amalgamation (s221) and putting the company into liquidation (s241). While the appointing and removing of directors is usually done by an ordinary shareholders resolution (simple majority vote) the other powers require a shareholders resolution to be passed by a majority of 75% (or higher if required by the company's constitution) of those shareholders entitled to vote, and voting on the decision.

SOMETIMES ALL OR NOTHING

There are instances where unanimous resolutions from shareholders may circumvent the requirements of the Act. Under s107 of the Act shareholders acting unanimously may authorise a dividend, approve a discount scheme, allow a company to acquire or redeem its own shares, provide financial assistance to purchase its own shares and sign off on benefits, guarantees, remuneration packages and the like for the company's directors. These unanimous resolutions however, do not override the requirement for the solvency test to be met by the company, and for the related director's solvency certificate under s108.

ROLE AT MEETINGS

Annual meetings are the most usual ones for shareholders to turn their minds to. Business carried out in such a meeting may be limited to receiving and adopting financial reports, election of directors, appointment of auditors, any other business requiring a special resolution and general business.

Special meetings can be called at any time to discuss a specific resolution provided the calling procedure has been adhered to.

In signing a resolution in lieu of a meeting each shareholder must ensure that all the requirements are included in the resolution and all matters to be resolved are clearly stated – if there is any doubt seek clarification, have it rectified or have the actual meeting

Chapter 16: How to Manage Business Risk Using Terms and Conditions of Trade

Many businesses operate without clear written terms and conditions of trade. Services are provided and goods are supplied without any clear record of who will cover the cost if something goes wrong. Taking the time to prepare clear and reasonable terms and conditions of trade can help ensure that your business risk is identified and properly managed. The team at Parry Field Lawyers is experienced at drafting terms of trade to ensure that risks associated with your work are clearly identified and allocated.

WHAT RISKS SHOULD MY TERMS AND CONDITIONS OF TRADE COVER?

Your terms and conditions should address a range of issues that create risk for your company. For most businesses, these include the risk of:

- unpaid debts;
- incurring liability for negligence or breach of contract;
- your employees and directors incurring personal liability for company activities;
- damage to goods during delivery process; and
- force majeure (unexpected) events.

To manage these risks you need to have clear terms and conditions of trade, and you need to ensure that those terms and conditions are brought to your customers' attention and accepted by them before you agree to provide goods or services to the customer.

The purpose of your terms and conditions should be to expressly deal with these risks and bind your customer to an agreement as to what happens if any of these risks occurs.

HOW CAN I ENSURE MY TERMS AND CONDITIONS ARE BINDING ON MY CUSTOMERS?

If you give quotations, your terms and conditions of trade must be inserted with the quotation form sent to the potential customer. If you don't use a quotation form, we strongly advise that terms of trade are sent to your customers anyway before you agree to carry out work for them. It is preferable to have your customers at least sign and fax back to you a copy of your terms and conditions. This gives you evidence that the customer saw and accepted your terms and conditions *before* the contract began.

If your business is typically done by oral agreements, don't be afraid of scaring customers off by asking for their signature on your quotation form or sending them a letter advising them of the terms and conditions upon which you will perform services. Getting things clear from the start will hopefully mean no misunderstandings later. Blame your terms and conditions on your lawyer if necessary. If a client is scared off, maybe it is a client you wouldn't want to have anyway! Paradoxically, if you produce a document for signing, it may well indicate a degree of professionalism to your clients. Also, beware of receiving orders which purport to be "given on the terms and conditions set out in our order form". This may bind you to their conditions.

PAYMENT TERMS

Your terms should specify when the contract price is to be paid and what interest you can charge on unpaid accounts. They should allow you to pass on your full legal and debt collection costs to the customer. They should ensure the customer gives you sufficient security for any goods or services you supply on credit. This security should be given in a form that complies with the Personal Property Securities Act 1999.

LIMITATION OF LIABILITY

Your terms and conditions should limit your maximum liability, and make it clear that you cannot be held liable for your customer's loss of profits, or any consequential or economic losses. You can also limit your liability to replacement, or refund of the particular defective item supplied or the particular defective service given. Your limitation of liability terms should also make it clear that your company's directors and employees are not personally directly liable to its customers.

Limitation of liability clauses can be complicated to prepare because historically the courts have tried to limit their application. A well drafted and reasonable limitation of liability clause can be effective in reducing your liability to customers to a manageable limit.

You also need to make sure that your limitation clauses comply with the Fair Trading Act 1986 and the Consumer Guarantees Act 1993. Where you supply consumer goods or consumer services to consumers, you cannot contract out of the provisions of the Consumer Guarantees Act. A limitation of liability clause that appears to release you from liability under the Consumer Guarantees Act may actually breach the Fair Trading Act.

When the Consumer Guarantees Act applies, you can still manage your risk of liability by, among other things, clearly and accurately setting out the limits of the goods and services you supply, and identifying any items that are not included.

WARRANTY TERMS

As mentioned above, the Consumer Guarantees Act 1993 imposes implied guarantees on suppliers of consumer goods and services. You can contract out of the Consumer Guarantees Act 1993 in relation to businesses, but not in relation to consumers. In relation to goods, the Sale of Goods Act 1908 may also impose warranties including that the goods are of merchantable quality and fit for the purpose for which the buyer is buying them. You can contract out of the Sale of Goods Act 1908.

In considering how to deal with warranties, you should also consider whether there are specific warranties that you do want to give your customers. An express warranty as to the quality of your goods and services can serve as a marketing tool that causes customers to choose your goods and services instead of your competitor's goods and services.

DELIVERY AND RISK

Your terms and conditions should expressly address who bears the cost if goods are damaged while being delivered to your customers, or there are any delays in completing delivery. For example, it is common for terms and conditions to specify that goods are at the customer's risk from the time they leave your premises, even if you are the person delivering the goods. This can help ensure that, if goods are damaged after they leave your premises, you are not responsible for the cost of repairing the damage.

FORCE MAJEURE (UNEXPECTED EVENTS)

Your terms and conditions should also excuse you from performance of your obligations to your customer if performance of your obligations becomes impossible because of an unforeseen event outside your control (such as an earthquake, terrorist act, or outbreak of war).

HOW CAN MY LAWYER HELP?

Because your terms and conditions will usually be used in connection with a very large number of sales, it is worth taking the time to make sure they are effective. In addition, particular businesses will have particular risks that are unique to that kind of business. The risks associated with a construction company will be different to those associated with a software company.

Your lawyer is the best person to advise you on what should be in your terms and conditions of trade and how to best ensure that the terms you trade on are yours, and not your customers.

Chapter 17: Administrative Details for Companies

ANNUAL RETURN

This must be completed once a year and filed with the Ministry of Commerce along with a filing fee. This provides outside parties with a summary of company details, including:

- registered office and address for service
- a list of charges the company has given
- names and addresses of directors and shareholders
- number of shares held by each shareholder
- the extent to which shares are paid
- changes in shareholdings - either through new issues or transfers of shares

With the advent of the internet, it is arguable that the annual return is now less relevant to outside parties - as a company summary can be obtained online at www.companies.govt.nz. (for a small fee). Nevertheless, the annual return remains an ongoing requirement which at least ensures each company's records are regularly updated. In any event, the failure to file an annual return can quite easily lead to the company being struck off the register

- a most undesirable result!

PARTICULARS OF DIRECTORS

Every appointment, removal, resignation, death or change of address of a director must be notified to the Companies Office within 20 working days of the relevant event. You should take steps to ensure you comply with this (although in the case of death, someone else will have to!) as the Ministry of Commerce are becoming increasingly vigilant in imposing fines. The notification has to be in a prescribed form acceptable to the Ministry of Commerce - if you have any doubts, see Parry Field.

REGISTERED OFFICE AND ADDRESS FOR SERVICE

Changes to these must be notified to the Ministry of Commerce 5 working days before the change is due to take place.

ACCOUNTING RECORDS

These must be kept in a manner which:

- correctly record and explain the transactions of the company
- enable the financial position of the company to be determined with reasonable accuracy
- enable the directors to ensure that the financial statements of the company comply with New Zealand law
- enable the financial statements of the company to be properly audited.

While the level of detail required by each company depends upon the nature of its business and transactions, it is clear that this obligation entails more than just a loose compilation of documents - a profit and loss statement, balance sheet and statement of cash flows will be required. For most companies, this will necessitate the involvement of someone with expertise in preparing accounts.

AUDITORS

An auditor must be appointed at each annual general meeting to audit the financial statements of the Company only if there are 10 or more shareholders. If the shareholders do not require the accounts to be audited, then a resolution to this effect must be signed by all shareholders each year.

However, if 25% or more of the Company is owned overseas, or if the Company is a public company, an auditor will be required notwithstanding any agreement by the shareholders.

Essentially, the auditor's job is to report whether accounting records have been kept by the company which comply with generally accepted accounting practice.

SHAREHOLDERS' MEETINGS

The Board of Directors must call an annual general meeting (AGM) of shareholders to be held within 6 months of the Company's balance date (or 10 months if all shareholders agree). Note that the balance date for almost all companies will be 31 March.

Each AGM must not be more than 15 months after the previous one was held (if the company is newly incorporated, the AGM must be within 18 months of incorporation).

In addition to this, if any special matter arises, any shareholder or shareholders with not less than 5 percent of voting rights, or the board of directors, may call a special meeting at any time to discuss and vote on the matter.

The need for an AGM or indeed any meeting can be avoided if 75% of voting shareholders (or such higher amount as required by the constitution) sign a resolution relating to a matter which would ordinarily be decided at such a meeting. Such a resolution would be as binding as if the shareholders has physically passed the motion at a meeting. Note however that if not all shareholders sign the resolution, those who do not sign must be sent a copy of the resolution within five working days.

If a meeting is held, the constitution of the company should set out how the shareholders are to be notified of the meeting, as well as how the meeting should be conducted - covering such matters as chairpersons, quorums and voting. If your company does not have a constitution, then the First Schedule to the Companies Act 1993 provides a default set of rules governing the conduct of meetings. Matters a company may wish to consider at a meeting include:

- consideration of the annual report, financial statements and auditor's report
- appointing directors and fixing remuneration
- appointing and fixing remuneration of an auditor
- discussing general business

DIRECTORS' MEETINGS

There is no obligation to hold directors meetings under the Companies Act 1993. While the Company's constitution will usually provide a procedure for these meetings (or the Third Schedule to the Act if there is no constitution), it will ordinarily be up to the Directors to determine when and where meetings are held.

OTHER MATTERS

There are many other matters your company may from time to time need to consider, such as:

- issuing or buying back shares
- making distributions to shareholders
- embarking upon a joint venture or amalgamation
- changing the company name
- adopting or altering the company constitution
- changing share rights
- entering contracts
- incurring obligations and purchasing assets
- liquidation or removal from the register

In these cases, there are usually specific forms to be completed or resolutions to be drafted. Contact Parry Field if you require assistance.



PART E EMPLOYMENT ISSUES

Chapter 18: Restraint of Trade and Conflict of Interest Clauses

RESTRAINT OF TRADE CLAUSES

There is a legal assumption that a restraint of trade is unenforceable unless the employer can prove they have a legitimate proprietary interest and that the restraint of trade is reasonable with regard to the circumstances. This typically requires the employer to establish a link between their proprietary interest and the duties and responsibilities of the employee who deals with those interests and the risk of breach. If the employer has proven these two elements, the burden then falls to the employee to show that the restraint is contrary to their personal interest and the general public interest.

The definition of proprietary interest includes three main categories: trade or customer connections, the stability of the employer's workforce, and trade secrets.

When considering whether a restraint of trade is reasonable, the Court will consider the context of the whole of the agreement between the parties and against the background of the circumstances in which the contract was entered into. In general, a restraint of trade will be reasonable where it grants adequate, but no more than adequate, protection for an employer.

REASONABLENESS – DURATION AND GEOGRAPHICAL LOCATION

When determining reasonableness, the Court will additionally consider how long the restraint of trade lasts for. When considering the validity of the restraint's duration, the Court will look at the facts and circumstances of the relevant company's business, the nature of the interest to be protected, and the potential effect of an ex-employee opening their own business. Industry practice will also be taken into account. In general, the Court will rarely find a restraint of trade clause that lasts for longer than one year to be reasonable.

The geographical coverage of a restraint of trade is also relevant when determining reasonableness. Worldwide restrictions are typically found to be invalid, unless the restriction requires worldwide coverage to be reasonably effectual.

The Court has upheld restraint of trade clauses where worldwide coverage was necessary because of the nature of the industry in question and the impracticalities of enforcing a less onerous restraint of trade clause; however, this is the exception, rather than the general rule.

CONSIDERATION

If an employee signs an employment agreement containing a restraint of trade provision, it is assumed there is consideration for the restraint of trade as this was part of the bargaining process. Therefore, a restraint of trade included in an employment agreement at the outset will not necessarily be unreasonable.

RESTRAINT OF TRADE CLAUSES – COURT POWERS AND CONTRACTING OUT OF THE COURT'S JURISDICTION

If a party cannot prove that a restraint of trade clause is enforceable, the Court has a jurisdiction to alter a restraint of trade to make it enforceable or to delete it from the employment agreement. This typically involves reducing the geographical coverage and/or the duration of the restraint. We are unsure whether parties can later agree to alter an invalidated restraint to make it enforceable, as we have not been able to find any case law on this point.

If the Court finds that an employee has breached a valid restraint of trade clause, it may require the ex-employee to pay exemplary and/or compensatory damages. It may also issue an injunction preventing an ex-employee from carrying out the conduct which constitutes a breach of the restraint of trade.

CONFLICT OF INTEREST CLAUSES

Case law seems to be silent as to the effect of conflict of interest clauses after the termination of an employment agreement. Therefore, if an employment agreement does not mention the effect of a conflict of interest clause post-employment, there is an argument that the conflict of interest clause no longer applies.

Chapter 19: Top Tips - Employing Staff in New Zealand

We have seen a lot of employers falling into some common pitfalls when interacting with their employees. These are our Top 10 Tips for employers for avoiding the most common employment relations issues.

- 1. Do a thorough pre-employment check.** Make sure to screen all potential employees before hiring them. Things such as criminal history, medical-and drug-testing, and good referee checks can help avoid employment problems down the road.
- 2. Finalise and sign employment agreements before an employee starts work.** The employment agreement is the most important document of the employment relationship, so make sure it is finalised and signed before the employee starts work. A 90 Day Trial Period will only be enforceable if the agreement is signed before the employee starts work.
- 3. Choose the correct employment agreement.** Whether you use a permanent, fixed-term, or casual agreement will depend on the circumstances, and each carries its own benefits and risks. Do not be tempted to use a fixed-term agreement to establish whether an employee is suitable for permanent employment.
- 4. Have policy documents on display and easily accessible.** Employee practices are often governed by company policies as well as by the terms of their employment agreement or job description. Whether they relate to health and safety, company vehicles, IT, or telecommunications, employees can only be bound by rules they are informed of, so have all policy documents accessible and encourage employees to read them.
- 5. Keep proper records of every employee.** This includes records of the employee's annual and sick leave entitlements, wage/salary records, job descriptions, and a copy of their employment agreement. Make sure you have a file for each employee, and that all their records are filed in it.
- 6. Always consult with employees before adjusting their hours, roles, or terms.** Employers cannot unilaterally change the terms on which an employee works. Consulting with employees on these matters is vital, and you may find that they have ideas you had not considered.
- 7. Keep up-to-date with developments.** The law is changing all the time; make sure to keep up-to-date with the latest changes to employment law, even where it seems irrelevant to your specific business. It may be that the law has wider application than you expected, or that it becomes relevant further down the track.
- 8. Act promptly and follow correct disciplinary and redundancy procedures.** Where you suspect an employee of misconduct or poor performance, act promptly and always follow clear and fair procedures. Never ambush employees with allegations or performance review meetings. Give employees full and timely notice of any disciplinary meetings, and allow them time to prepare and respond.
- 9. Do not be afraid to go to mediation.** Most employment problems can be resolved by either informal negotiation or in mediation. Mediation is a voluntary and highly flexible method of resolving disputes, and often leads to mutually satisfactory outcomes.
- 10. When in doubt, come to us.** Whenever you have concerns about an employee or the terms of your employment agreements, talk to your lawyer before taking any steps. We can help to determine the best approach to take, resolve disputes as quickly as possible, and assist in improving your employment agreements.

PART F ANNEXURE

Chapter 20: Company Register Practical Guide

The following notes are intended to be a practical guide as to how to “fill in the gaps” for the company registers, rather than a comprehensive run down on the law. These notes should be read in conjunction with the registers themselves, many of which are self-explanatory.

Many companies will probably have a “who cares?” or “waste of time!” attitude to keeping registers. It is true that there is an element of time involved in maintaining accurate and up to date registers. However, the demands are not too burdensome (mainly simple form filling) and, compared to the potential penalties for noncompliance with the registers (between

\$5,000 and \$10,000 both for the company and every director), a little time invested regularly can avoid problems later on.

REGISTER OF DIRECTORS

This is fairly self-explanatory. Note however, that the full residential addresses of directors must be given - post office box addresses will not suffice. And full names too - including middle names.

REGISTER OF DIRECTORS' (GENERAL AND SPECIFIC) INTERESTS

Directors' interests (also discussed in the section on directors' duties) must be disclosed when they are a party to or may obtain a “material financial benefit” from a transaction with the company, or when they are connected to another party by being a director, officer, trustee or even family member of that party.

What is “material” is not entirely clear - however, it would pay to err on the side of excess when considering whether or not to make disclosure, rather than be the unfortunate guinea pig who helps clarify the position in a court of Law!

Disclosure may be made in one of two ways. First, each specific interest can be disclosed in the register, in which case the nature and extent of the interest, as well as its monetary value (if able to be quantified) must be disclosed.

Alternatively, if a director gives notice that he or she is a director, shareholder, officer or trustee of another party and is to be regarded as interested in any transaction entered into with that party, this is sufficient disclosure for all subsequent transactions between the company and that party.

It would seem that this second, general disclosure is preferable if there are continuing transactions between the company and the other party - the disclosure is not nearly so onerous as making specific disclosure in each transaction.

Note that, in addition to disclosure in the interests register, disclosure must also be made to the board of directors. While it is arguable that this is unnecessary where the board are already aware of the interest, it would be prudent to make this disclosure anyway.

REGISTER OF BENEFITS RECEIVED BY DIRECTOR

This must contain details of every instance where the company:

- makes a payment for directors' remuneration
- provides a benefit to a director for services rendered in any capacity
- makes a payment to a director of compensation or loss of office
- makes a loans to a director
- gives a guarantee for debts incurred by a director

It appears that the actual monetary amount of the benefit must be disclosed in the register. This would include director's salaries, and is a fuller disclosure than the “banded” or grouped disclosure required in a company's annual report.

The directors who vote in favour of giving benefits to a director must sign a certificate stating their opinion that the benefit is fair to the company.

If the Act's procedural requirements are not complied with, the director is personally liable to repay the value of the benefit to the company, except to the extent he or she can prove it was fair.

REGISTER OF DIRECTORS CERTIFICATES

There is no legal requirement to keep this register - it is simply a matter of administrative convenience. However, there is a requirement to give certificates in a number of circumstances, such as declaring dividends, setting director's remuneration, taking out insurance for directors, providing indemnities and amalgamating. Given the heavy penalties for non-compliance, this register comprises a useful historical record of certificates issued.

REGISTER OF INFORMATION TO BE USED/DISCLOSED

This is touched on in the section on directors' duties.

While "particulars" of information to be disclosed must be recorded in the register, it is possible that this need not be so detailed that the confidentiality of the information would be lost - this is logical since all shareholders have a right to inspect this register and it would be unreasonable if they could learn the eleven secret herbs and spices simply by viewing the register!

Also, if disclosure is to be made to a person whose interests the director represents, the name of that person must be entered into the interests register.

REGISTER OF DIRECTORS/EMPLOYEE'S INDEMNITY AND INSURANCE

If you have read the section on directors' duties, you will have seen that the potential for personal liability has escalated under the 1993 Act. For many companies, availing themselves of the indemnity and insurance provisions of the Act will be a must.

Indemnities

A company may indemnify a director or employee for:

1. costs incurred in any proceeding against a director which relates to an act or omission in his or her capacity as a director or employee provided those proceedings have a favourable outcome; or

2. for any liability to a third party unless it is criminal liability or involves a breach of the duty to act in good faith and in the best interest in the company.

Insurance

This can be effected for a director or employee in respect of non-criminal liability - including costs incurred in settling or defending any such claims or for costs incurred in defending any criminal proceedings in which they are acquitted.

Note that:

- A company's constitution must allow such indemnities or insurance before they can be effected by the board - if your company did not reregister, you won't have a constitution and will not be able to take advantage of these provisions - unless you adopt a constitution.
- You can't insure or indemnify outside the limits set out above - any attempt to do so will be void.
- Particulars of insurance/indemnities must be disclosed in the interests register. Perhaps going further and attaching a copy of any insurance policy to the register would be prudent.
- The directors must sign a certificate certifying that, in their opinion, the cost of effecting insurance is fair to the company.

REGISTER OF ACQUISITION OR DISPOSITION OF SHARES BY DIRECTORS

Directors who hold shares in any company which has been reregistered under the 1993 Act must disclose that shareholding along with particulars in this register.

For *all* companies, a director who has a "relevant interest" in the buying or selling of shares must also provide details in this register.

"Relevant interest" is defined broadly and includes shareholding as a trustee, or having the right to control at least 20% of the votes attached to a share.

REGISTER OF REGISTERED OFFICE AND REGISTER OF ADDRESS FOR SERVICE

A company must now have both of these - they need not be the same address. Both must be physical, rather than postal addresses. The main distinction between the two is that the Registered Office is the address where records are kept and the address for service is where documents (legal or otherwise) can be served on the company.

REGISTER OF DOCUMENTS EXECUTED EQUIVALENT TO DEEDS

There is no legal requirement to keep this register, but it is useful to keep a record of documents entered into by the company. It may be useful for providing dates and parties later on, especially if the original deed or agreement is lost (not by your solicitor of course!)

Remember that common seals no longer have any effect in execution of a deed unless the company constitution states that its affixing is necessary. For all deeds, two directors or one director in the presence of a witness (who records their name, address and occupation) must sign to make it valid.

SHARES ISSUED AND PAYMENTS MADE

This is useful in that it records shares issued in a chronological order. It also keeps track of how much each share is issued for and how much is paid up on it. This may become relevant when you want to transfer your shares and are required to warrant that they are fully paid up.

SHARE TRANSFER JOURNAL

This register provides a chronological record of shares transferred - including when the board refuses to approve such a transfer (they will generally only have limited grounds for doing so, which should be outlined in the company constitution).

REGISTER OF SHARE CERTIFICATES

Under the 1993 Act, it is no longer compulsory to issue share certificates to shareholders - only when a shareholder requests one. If they do, the certificate must include the company's name, class and number of shares. This register is simply a record of when and to whom these are issued.

REGISTER OF STATEMENT OF RIGHTS ISSUED

A shareholder can insist on being sent a statement setting out the rights attaching to their shares and their relationship with other classes of shares. A shareholder can only request this at a minimum of six monthly intervals. Keeping a register of these requests helps a board know when it is entitled to refuse a badgering shareholder's repeated requests.

THE SHARE REGISTER

This is a public record, which must usually be kept at a company's registered office. While the board have the ultimate responsibility to maintain a register, the physical task of administration may be delegated to an agent.

The actual information required is fairly self-evident from the register itself.

Matters to note however include:

- acquisitions, dispositions, redemptions and all other "tions" of shares within the previous ten years must be recorded.
- a separate register has to be kept for each shareholder and they must be in alphabetical order.
- no evidence of a trust is to be entered on the share register - you must show the trustee as a individual or as "Joe Bloggs (jointly)" if held with another trustee.
- if the shares are not 'ordinary' shares, you must disclose where the document which contains the rights, privileges or restrictions which distinguish them from ordinary shares (generally the constitution) can be inspected.

To the heart of what matters.



Chapter 21: Review and discussion of key points from "The Lean Startup" by Eric Ries

Review by Steven Moe, Parry Field Lawyers

Being involved as the founder of an IT start-up (Active Associate – a chat bot for law firms) this book was recommended to me as essential reading. The subtitle is: "How Today's Entrepreneurs Use Continuous Innovation to Create Radically Successful Businesses".

It definitely provides a lot of good ideas as the main point is that you should constantly be evolving – don't try and build the perfect product. Particularly with software that is important to remember because demands shift and change so quickly among consumers.

The author outlines more about that basic point as follows:

After more than ten years as an entrepreneur ... I have learned from both my own successes and failures and those of many others that it's the boring stuff that matters the most. Startup success is not a consequence of good genes or being in the right place at the right time. Startup success can be engineered by following the right process, which means it can be learned, which means it can be taught.

He summarises the five key principles regarding the Lean Startup idea as follows:

1. Entrepreneurs are everywhere. So the Lean Startup approach can work with any size of company or sector.
2. Entrepreneurship is management. Startups require new types of management given their context of uncertainty.
3. Validated learning. Startups exist to learn how to build a sustainable business. This learning can be tested and validated.
4. Build-Measure-Learn. Startups turn ideas into products, measure how customers respond, and then learn whether to pivot or persevere.
5. Innovation accounting. Need to measure progress, set up milestones, and how to prioritize work.

The main takeaway from the book is the need to continually innovate and evolve and not settle or try to have a "perfect" solution before you actually start rolling it out to your customers. In order to give a taste of the concepts that the author then goes on to outline here are some key quotes that I found were the most interesting and potentially the most applicable to many others:

- *The Lean Startup asks people to start measuring their productivity differently. Because startups often accidentally build something nobody wants, it doesn't matter much if they do it on time and on budget. The goal of a startup is to figure out the right thing to build – the thing customers want and will pay for – as quickly as possible.*
- *In the Lean Startup model, every product, every feature, every marketing campaign – everything a startup does – is understood to be an experiment designed to achieve validated learning.*
- *This is one of the most important lessons of the scientific method: if you cannot fail, you cannot learn.*
- *What differentiates the success stories from the failures is that the successful entrepreneurs had the foresight, the ability, and the tools to discover which parts of their plans were working brilliantly and which were misguided, and adapt their strategies accordingly.*
- *A minimum viable product (MVP) helps entrepreneurs start the process of learning as quickly as possible. It is not necessarily the smallest product imaginable, though; it is simply the fastest ways to get through the Build-Measure-Learn feedback loop with the minimum amount of effort.*
- *Contrary to traditional product development, which usually involves a long, thorough incubation period and strives for product perfection, the goal of the MPV is to begin the process of learning, not end it.*
- *It's often about gaining a competitive advantage by taking a risk with something new that competitors don't have yet.*
- *Only 5 percent of entrepreneurship is the big idea, the business model, the whiteboard strategizing and the splitting up of the spoils. The other 95 percent is the gritty work that is measured by innovation accounting: product prioritisation decisions, deciding which customers to target or listen to, and having the courage to subject a grand vision to constant testing and feedback.*

As a lawyer I found the following quote quite interesting because it is definitely something we see among our clients with early stage ideas. They often are worried about someone stealing the idea and so ask about patents, copyright, trademarks etc. But often it is the best advice just to start doing something and learn as you go and be the front runner in the industry rather than trying to have everything sorted and perfect in advance.

Legal risks may be daunting, but you may be surprised to learn that the most common objection I have heard over the years to building an MVP is fear of competitors – especially large established companies- stealing a startups ideas. If only it were so easy to have a good idea stolen! Part of the special challenge of being a startup is the near impossibility of having your idea, company, or product be noticed by anyone, let alone a competitor.

I found the sections where he described the businesses that he had been involved with were the best parts (rather than describing what other people had done). For example, these were the four questions that he asked his team:

1. *Do consumers recognise that they have the problem you are trying to solve?*
2. *If there was a solution, would they buy it?*
3. *Would they buy it from us?*
4. *Can we build a solution for that problem?*

The common tendency of product development is to skip straight to the fourth question and build a solution before confirming that customers have the problem."

Overall this book was helpful for me to read through although the key concepts are outlined above and so it felt like it was a longer book than it needed to be. But that is just my own impression and others might enjoy the variety of stories that are told.

Chapter 22: You have the Power to Change Stuff Review

This is a review of a book telling the story of a social enterprise in Australia called "Thankyou". This review highlights some of the key points of interest in their story and the challenges the author has set for the readers.

This is a book about social enterprise which is a really interesting and challenging read. I think it will be relevant to a lot of people involved in charities and not for profits as well as those looking to start one. There are a lot of concepts and thoughts in this book which align well with many of our social enterprise clients (even if many of our clients may not realise that is what they are). The traditional words for them have been "not for profit" or "charity" and they probably have never called themselves "social enterprises" but that is really what they are!

So turning to the book it is "different" in a few distinctive ways. For one, when I bought it the person at the store said, "How much do you want to pay?" It seems that you can choose the price. The money then goes towards funding "Thankyou" which is the organisation the author co-founded. On a communication from them when I joined their newsletter it says about this price: "It's sold at a pay what you want price to fund the future of Thankyou and so far, has crowd-funded the launch of Thankyou New Zealand! WIN!"

The other distinctive is when you open the book all the text is opposite to the usual format for a book. It runs from left to right across the page so you have to turn it 90 degrees onto its side and read it almost like a flip chart. So from the outset you can tell that the author is trying to do something different. Trying to challenge the status quo. He acknowledges this a little later when talking about this format:

"Once you get out of your comfort zone, you begin to actually ask questions - and you start thinking and challenging what you've always accepted as the norm. The reality is that stepping out is uncomfortable. Even as you read this book 'the wrong way around' in airport lounges, on public transport, on your way to school or work or around friends, there's a chance you'll feel uncomfortable. Why? Because there is the possibility that people will notice your re doing something differently. We live in a world where we can blend in fairly easily, that is until the moment you take a risk and attempt something that perhaps no one has done before."

The story itself centres on three young people who had an idea in Australia that has resulted in "Thankyou". They started it when they were just 19 years old. The back cover describes what they did as beginning with the world water crisis and how to end it but that "has developed into award-winning consumer goods brand that empowers millions of people to fight poverty with every munch of muesli, sip of water or pump of hand wash".

Essentially they brand around 35 products and then the funds raised from the sale of those products goes to support, for example, water projects in Africa (from sale of water), health projects (from sale of body care products) and food programs (from sale of food products). You can read more about them online at <https://thankyou.co/>. As noted above it looks like they will be launching in NZ soon.

The book is called Chapter One because the author acknowledges up front that their story is just beginning. He uses that as an encouragement to try and say that we can try things as well because they are just at the start of their journey. He plans to write a "Chapter 2" in a few years' time when they are further down the road. The opening page makes this a call to be included on their journey as he writes, "Our world doesn't need another book; it needs an idea that could change the course of history. Write with us." He writes later:

"This book is written as we go, to show you that any one individual, any group of people, can make their ideas and dreams a reality. You may not have 'made it' yet (and neither have we), but everything we have learned along the way we want to share with you, in the hope that it will encourage you, inspire you and empower you."

The 13 chapters have catchy headings like "Turning stumbling blocks into stepping stones", and "Build a great team to achieve a great dream". In each chapter anecdotes and stories are told about the experiences of the author. What I found helpful was the honesty about their journey - not trying to pretend that they have "made it" but instead writing in a way to try and encourage others to try something new. The book is full of challenges to the status quo and trying to do things differently. An example of this is the following quote:

"Some people don't think the game will ever change. But it always does. And if you aren't convinced the game will change, it's probably best to keep those thoughts to yourself, otherwise years later you might find yourself mentioned in a quote like this: 'the iPhone is nothing but a niche product' - then CEO of Nokia in 2008."

There are many quotes like this and there are several direct references to New Zealand as well. For example, when describing why they want to launch Thankyou in New Zealand he writes:

"We want to empower New Zealanders, the way we've empowered Australians, to show the world that consumers have the power to change stuff. Many of the biggest brands in the world trial ideas in New Zealand because it's widely known that if a concept works in New Zealand, it will work globally. So we've invited New Zealand to help take this movement to the next level. The thing is, we're not just launching Thankyou Australia into New Zealand. Instead, we're launching Thankyou New Zealand from scratch. We'll be setting up a local team, local suppliers and local impact partners. Coinciding with this book arriving on shelves, we launched our boldest and most ambitious campaign yet, inviting both Australians and New Zealanders to make a choice - to either help launch Thankyou New Zealand or not to. Will it work? We can't guarantee that it will. But I love this thought: if it does, then together two of the smallest countries in the world (at times underestimated), who both bat above their weight globally in sport, entertainment and music, could go not to do something the likes of which the world has never seen before."

Is this book a world changer? No. But that would be too much to ask of anything. What it does provide is a call to move in the right direction. What is needed is for many people to start questioning the way things have always been done and this book is good because it does that. It also is empowering because it shares a journey that the author is just starting which makes it seem more possible to join in some way. Perhaps the sentiment was best summed up in one of my favourite books as a child, "The Lorax", where Dr Seuss ends with the following lines:

"Unless someone like you cares a whole awful lot, Nothing is going to get better. It's not."

And that is really the theme of this book too. We need to care. We need to demand change. We need to be the change. I would recommend this book to people who are looking for an inspiring and ultimately challenging read. It will definitely be interesting to see how Thankyou goes in New Zealand since we will have a front row seat on their launch here.

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