



# AUCKLAND DISTRICT LAW SOCIETY INC

INDEPENDENT VOICE OF LAW

24 June 2016

Ministry of Business,  
Innovation & Employment  
15 Stout Street  
Wellington 6011

By email only to: [societies@mbie.govt.nz](mailto:societies@mbie.govt.nz)

Dear Sir or Madam,

## **Submission by Auckland District Law Society Inc. Commercial Law Committee**

The Commercial Law Committee of Auckland District Law Society Inc. ("the Committee") welcomes the opportunity to comment on the Exposure draft of the Incorporated Societies Bill.

The Committee's submission is **enclosed**.

The Committee hopes these comments will be of some assistance. Please contact the undersigned should you have any queries.

Yours faithfully,

Withheld

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## **AUCKLAND DISTRICT LAW SOCIETY INC**

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## **Incorporated Societies Bill - Exposure Draft**

### *General Comments*

We welcome the Government's response to the Law Commission's main recommendation to replace the 1908 Act with a new Incorporated Societies Act.

We welcome the clarity that a new Act will bring, especially:

- that societies cannot be established for the financial gain of members;
- that a society can do all the things that an individual can lawfully do (e.g. enter into contracts), subject to their constitutions;
- how a society must manage disputes between members, and between members and the society;
- the obligations on officers (or board members) to act in good faith, act in the best interests of the society and avoid reckless or risky activities;
- those situations where an officer's duties of loyalty to a society would come into conflict with a competing personal interest; and
- a society's annual financial reporting requirements.

## *Our Specific Comments*

### (1) Purpose of the new act

The purpose of the new Act is set out in clause 3. Overall the Act provides for the incorporation of societies for lawful purposes other than financial gain, based on the following principles:

- (i) societies are organisations with members who have the primary responsibility for holding the society to account; and
- (ii) societies are private bodies that should be self-governing and free from inappropriate Government interference; and
- (iii) societies should not distribute profits or financial benefits to their members.

We support the overall purpose of the Act and its principles. As many societies operate within a framework involving local government, we particularly support principle (ii) and would support the term 'Government' being defined to include local government.

### (2) Capacity, powers and validity of actions

Clause 17 provides that incorporated societies have the capacities and powers of a natural person. In essence, this means that a society can do all the things that an individual can lawfully do (e.g. enter into contracts), subject to their constitutions (and especially their purposes) and the principle that they must not be carried on for financial gain.

We support the 'examples' of powers given following clause 17 and agree with the approach of these being 'examples' rather than powers specified in the Act.

#### **Examples**

A society's powers include (subject to any restrictions in its constitution under **sub-section (3)**) powers to—

- buy, sell, exchange, develop, and mortgage property:
- borrow money and give security for it:
- issue negotiable instruments:
- receive and make gifts (see, however, **subpart 2**, which contains restrictions relating to financial gain):
- enter into contracts and leases:
- employ persons:
- belong to other societies or associations.

Clause 20 provides for persons not to be treated as having knowledge of an incorporated society's constitution merely because it is registered or available for inspection as follows:

A person is not affected by, or deemed to have notice or knowledge of the contents of, the constitution of, or any other document relating to, a society merely because—

- (a) the constitution or document is registered on the register; or
- (b) it is available for inspection at an office of the society.

We support the intention to ensure that the common law ultra vires doctrine does not apply so as to protect bona fide third parties transacting with a society who may be unaware of restrictions imposed by the society's constitution.

However, as the term 'person' is not defined, it arguably also includes members and officers of the incorporated society. We do not believe this to be the intention of section 20 as this would yield untenable results, particularly, in relation to section 31 (Procedures in constitution for grievances and complaints) and section 50 (Officers to comply with Act and constitution).

We suggest that a new subsection is inserted into section 20, clarifying that the term ‘person’ does not include members and/or officers of the incorporated society.

### (3) Society must not operate for financial gain

Clause 21 expands upon the principle that a society must not be carried on for the financial gain of any of its members and makes it an offence by an officer of a society to do so (for the most serious breaches).

Clause 22 defines “financial gain”. A society must be treated as having a purpose of financial gain if:

- (a) it distributes, or may distribute, any gain, profit, dividend, or other financial benefit to any of its members (whether in money or in kind); or
- (b) it has, or may have, capital that is divided into shares or stock held by its members; or
- (c) it holds, or may hold, property in which its members have a disposable interest (whether directly, or in the form of shares or stock in the capital of the society or otherwise).

Clause 22 also usefully lists seven exclusions from the meaning of financial gain (to make it clear that these activities do not contravene the financial gain prohibition) as follows:

- (a) engage in trade:
- (b) pay a not-for-profit member for matters that are incidental to the purposes of the society (*see subsection (4)*):
- (c) reimburse a member for reasonable expenses legitimately incurred on behalf of the society or while pursuing the society’s purposes:
- (d) provide benefits to members of the public or of a class of the public and those persons include members of the society or their families:
- (e) pay a member a salary or wages or other payments for services on arm’s length terms (*see subsection (5)*):
- (f) enter into any other transaction with a member on arm’s length terms (*see subsection (5)*):
- (g) provide a member with incidental benefits (for example, trophies, prizes, or discounts on products or services) in accordance with the purposes of the society.

Because of the importance of the principle that a society must not operate for financial gain, we support this being clearly set out in clauses 21 and 22 (together with the clear list of activities that are allowed or exclusions).

### (4) What a constitution must contain

Every society must have a constitution that complies with section 24:

The constitution must contain rules regarding the following:

- (a) the name of the society; and
- (b) the purposes of the society; and
- (c) how a person becomes a member of the society, including a requirement that a person must consent to be a member; and
- (d) how a person ceases to be a member of the society; and
- (e) arrangements for keeping the society's register of members up to date; and
- (f) whether, and if so how, the society will provide access for members to the register of members; and
- (g) the composition, roles, and functions of the committee of the society, including—
  - (i) the number of members that must or may be on the committee; and
  - (ii) the election or appointment of committee members; and
  - (iii) the terms of office of the committee members; and
  - (iv) the functions and powers of the committee; and
  - (v) grounds for removal from office of committee members; and
  - (vi) how the contact officer will be elected or appointed; and
- (h) how the society will control and manage its finances; and
- (i) the control and use of the society's common seal (if it has one); and
- (j) procedures for resolving disputes between members (in their capacity as members) and between members and the society, including procedures for investigating and dealing with—
  - (i) the grievances of members relating to their rights and interests as members; and
  - (ii) complaints concerning the misconduct or discipline of members; and
- (k) arrangements and requirements for general meetings, including—
  - (i) the intervals between general meetings; and
  - (ii) the information that must be presented at general meetings; and
  - (iii) when minutes are required to be kept; and
  - (iv) the manner of calling meetings; and
  - (v) the time within which, and manner in which, notices of general meetings and notices of motion must be notified; and
  - (vi) the quorum and procedure, including voting procedures, for general meetings; and
- (l) the method by which the constitution may be amended; and
- (m) the nomination of a not-for-profit entity, or a class or description of not-for-profit entities, to which any surplus assets of the society should be distributed on a liquidation of the society or the removal of the society from the register (*see subsection (4) and subpart 5 of Part 5*).

As noted by MBIE, most existing societies already have provisions in their current constitutions that comply with 11 of the 13 requirements of clause 24(1). The two usual exceptions are: clause 24(1)(j), which requires the constitution include rules relating to the resolution of disputes between members, and between members and the society; and clause 24(1)(m), which requires a society to nominate a not-for-profit entity or class of not-for-profit entity to which any surplus assets should be distributed on the liquidation or deregistration of the society.

With regard to disputes between members, and between members and the society, the Exposure Draft sets out these requirements in more detail in clauses 31 and 32:

### *Grievances and complaints*

#### **31 Procedures in constitution for grievances and complaints**

- (1) The procedures referred to in **section 24(1)(j)** must—
  - (a) be consistent with the rules of natural justice; and
  - (b) at a minimum, comply with the requirements of **Schedule 2**.
- (2) See **subpart 1 of Part 4** (which provides for a court to make orders enforcing a society's constitution, including the procedures in the constitution for grievances and complaints).

#### **32 Constitution may provide for arbitration**

- (1) A society's constitution may provide that all or certain kinds of complaints or grievances referred to in **section 24(1)(j)** must or may be submitted to arbitration under the Arbitration Act 1996.
- (2) If a society's constitution provides that complaints or grievances must or may be submitted to arbitration under the Arbitration Act 1996, the relevant provisions of the constitution must be treated as an arbitration agreement that is binding on the society and the affected member.
- (3) A society's constitution may prescribe procedural matters (not inconsistent with the Arbitration Act 1996) that govern an arbitration under this section.

Further, minimum requirements are set out in Schedule 2:

### **Schedule 2** **Complaints and grievances procedures**

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#### **1 Complaints: member's right to be heard**

- (1) If a society considers a complaint, or institutes a disciplinary procedure, regarding alleged misconduct of a member, the member has a right to be heard before the complaint or procedure is resolved or any outcome is determined.
- (2) Without limiting the manner in which a member may be given a right to be heard, a member must be taken to have been given the right if—
  - (a) the member is fairly advised of all allegations concerning the member, with sufficient details and time given to enable the member to prepare a response; and
  - (b) the member has a reasonable opportunity to be heard in writing or at an oral hearing (if one is held); and
  - (c) an oral hearing is held if the decision maker considers that an oral hearing is needed to ensure an adequate hearing; and
  - (d) an oral hearing (if any) is held before the decision maker and the member's written statement or submissions are considered by the decision maker.

#### **2 Grievances: member's right to be heard**

- (1) If a society considers a member's grievance alleging damage to the member's rights or interests as a member or to members' rights or interests generally, the member has a right to be heard before the grievance is resolved or any outcome is determined.
- (2) Without limiting the manner in which a member may be given the right to be heard, a member must be taken to have been given the right if—
  - (a) the member has a reasonable opportunity to be heard in writing or at an oral hearing (if one is held); and
  - (b) an oral hearing is held if the decision maker considers that an oral hearing is needed to ensure an adequate hearing; and
  - (c) an oral hearing (if any) is held before the decision maker and the member's written statement or submissions are considered by the decision maker.

#### **3 Investigating and determining complaint or grievance**

- (1) A society must, as soon as is reasonably practicable after receiving a complaint or grievance made in accordance with its constitution, investigate and determine the complaint or grievance.

- (2) Those complaints and grievances must be dealt with by the society in a fair, efficient, and effective manner.
- 4 Society may decide not to progress complaint or grievance**  
 Despite **clause 3**, a society may decide not to proceed with a matter further if—
- (a) the matter is trivial; or
  - (b) the matter does not appear to disclose—
    - (i) in the case of a complaint, any material misconduct; or
    - (ii) in the case of grievance, any material damage to a member's rights or interests; or
  - (c) the complaint or grievance appears to be without foundation or there is no apparent evidence to support it; or
  - (d) the person who makes the complaint or brings the grievance has an insignificant interest in the matter; or
  - (e) the conduct, incident, event, or issue has already been investigated and dealt with by or on behalf of the society.
- 5 Society may refer complaint to subcommittee or other investigator**  
 A society may refer a complaint or grievance to—
- (a) a subcommittee or an external person to investigate and report; or
  - (b) a subcommittee, an arbitral tribunal, or an external person to investigate and make a decision.
- 6 Decision makers**  
 A person may not act as a decision maker in relation to a complaint or grievance if 2 or more members of the committee or a complaints subcommittee consider that there are reasonable grounds to believe that the person may not—
- (a) be impartial; or
  - (b) be able to consider the matter without a predetermined view.

It might be noted that in our experience while the constitutions of most societies currently include provisions for the disciplining of members, they do not include rules relating to the resolution of disputes between members themselves or between members and the society.

We welcome the clarity these clause will bring to dispute resolution.

#### (5) Officers' duties

Clauses 48–55 provide that an officer (i.e. a board member), when exercising powers or performing duties, must act in good faith and in what the officer believes to be the best interests of the society. The powers must also be exercised for a proper purpose, in accordance with the Act and the Constitution of the society and with the care and diligence of a reasonable person (a duty of care). An officer must also avoid the activities of the society being carried on in a manner likely to create a substantial risk of serious loss. The definition of officer in clause 36 further clarifies who owes these duties.

We support these clauses that clarify the role of officers.

However, as many societies are now professionally run (on either a full time or part-time basis), we suggest that section 36 and perhaps also sections 48-55 be clarified further (perhaps by way of an example or explanatory note) to make it quite clear that the 'management' of an incorporated society (e.g. the CEO) are also bound by these 'officer duties'.

#### (6) Conflict of interest disclosure rules

Clauses 56-65 cover those situations where an officer's duties of loyalty to a society come into conflict with a competing personal interest. There are five situations when a person is considered to have an interest:

- (a) may derive a financial benefit from the matter; or
- (b) is the spouse, civil union partner, de facto partner, child, or parent of a person who may derive a financial benefit from the matter; or
- (c) may have a financial interest in a person to whom the matter relates; or
- (d) is a partner, director, officer, board member, or trustee of a person who may have a financial interest in a person to whom the matter relates; or
- (e) may be interested in the matter because the society's constitution so provides.

Clause 56 also lists three situations where a person is deemed to be disinterested so as to increase legal certainty:

- (a) merely because he or she receives an indemnity, insurance cover, remuneration, or other benefits authorised under this Act; or
- (b) if his or her interest is the same or substantially the same as the benefit or interest of all or most other members of the society due to their membership; or
- (c) if his or her interest is so remote or insignificant that it cannot reasonably be regarded as likely to influence him or her in carrying out his or her responsibilities under this Act or the society's constitution.

An officer who is interested in a matter must disclose details of the nature and extent of the interest (including any monetary value) to the committee and record this in an 'interests register' kept by the committee. An officer who is interested in a matter relating to a society:

- (a) must not vote or take part in the decision of the committee relating to the matter; and
- (b) must not sign any document relating to the entry into a transaction or the initiation of the matter; but
- (c) may take part in any discussion of the committee relating to the matter and be present at the time of the decision of the committee (unless the committee decides otherwise).

Clause 65 provides that the 'interests register' must be made available for inspection by officers of the society and may (if the constitution allows) be made available to other members of the society.

We support these clauses that clarify when conflicts of interest may occur, their disclosure and what officers must do in the event of a conflict.

Again, however, as many societies are now professionally run, we ask that these sections be clarified further (perhaps by way of an example or explanatory note) to make it quite clear that the 'management' of an incorporated society (e.g. the CEO) are also bound by these clauses.

## (7) Request for Information

Clause 71 of the Bill allows for a member to make a written request for information held by the society. Clause 71(4) sets out a range of reasons why information may be withheld. However, these reasons are not exclusive and the society may refuse for other grounds, whatsoever.

We submit that there is merit for turning this around to provide that there are only specified grounds on which a society can refuse to disclose information

## (8) Financial reporting

Under the current 1908 Act, incorporated societies must lodge annual financial statements with the Registrar in their annual returns. There are no accounting standards to govern this reporting. Hence, it is largely left to each society to decide when and how to recognise transactions, how to measure them, and what to disclose. This means that a wide variety of practices are used, some



of which are inconsistent with generally accepted accounting practice.

Clause 83 aims at promoting higher quality and more consistent reporting by requiring all societies to prepare financial statements in accordance with accounting standards issued by the External Reporting Board ('XRB'). Societies with annual operating expenditure \$2 million or less will be able to prepare in accordance with the XRB's simple format reporting standards for not-for-profit entities (tiers 3 or 4), while societies with expenditure above tier 3 or 4 reporting will be required to prepare in accordance with the more extensive tier 1 or 2 not-for-profit entity accounting standards.

We support these clauses that clarify financial reporting requirements.

However, Hui E! considers this to be a major compliance burden for small societies and given Incorporated Societies get no tax benefit (as do charities and their donors) this creates an disincentive to formation of societies and undermines the ease at which a community based legal entity can be established in New Zealand.

We acknowledge the merit the introduction of standards will bring but maintain that compliance should be based on subjective factors (i.e. membership, assets and income etc). Imposing onerous standards on small Incorporated Societies with low income and few assets is likely to create a major burden with no related benefit. Incorporated Societies such as these will usually have a high level of transparency and good understanding of their accounting arrangements and would not welcome having to spend already scarce resources on compliance costs.

The ADLSI's 2011 submission suggested the use of 'stepped' compliance. We believe tests similar to those used in the Financial Reporting Act could be successfully adopted here. For example if a society has more than 100 members and gross income of more than \$100,000 then perhaps that should trigger the higher standards of accounting (e.g. accrual accounting) and mandatory annual audit obligations. These obligations could potentially be negated (much in the same way as shareholders can cause companies to avoid audit obligations) by members resolving at an AGM. The issue would then become of what proportion of members could avoid the default position.

We advocate that accounting and reporting for societies be looked at in a wider context, rather than in isolation. The principles underlying thresholds for full reporting on the basis of being a public issuer or having a proportion of overseas ownership for other entities, and the ability of privately owned entities no matter what their size to retain confidentiality and not have to publicly report, need to be carefully considered for societies.

We suggest that the financial reporting obligations under the bill are 'stepped' by member size and income, but that there be a provision for these to be negated by an acceptable proportion of members (either 75% or perhaps 90% if this is considered to be a special right or obligation) voting at an AGM.

#### (9) Sub-Committees

Hui E! has expressed their concern that the bill does not adequately address the ability of incorporated societies to form sub-committees and whether it requires the addition of a provision that requires a sub-group of the governance to report regularly to the main board.

We do not believe that anything more is required to be added to the Bill as a result Hui E's question above. We are of the view that there is already sufficient flexibility in the Bill to deal with sub-committees and their responsibilities, on a case by case basis.

In this context, we note that clause 24(1)(h) of the Bill provides that the constitution of the Society must contain rules regarding how the society will control and manage its finances. Clause 38(1) of the Bill provides that the operation and affairs of a society must be managed by,

or under the direction or supervision of its committee. Likewise, clause 38(2) provides that the committee has all powers necessary for managing and for directing and supervising the management of the operation and affairs of the society.

The Bill does not restrict any society from forming sub-committees and indeed seems to anticipate that, on a case by case basis, this will be done. If any sub-committee is formed the committee will clearly wish the sub-committee to report back to it (as the committee remains the entity primarily liable for any actions of the sub-committee) but the detail around how the reporting back is to be conducted should be left for each society in its constitution. Reporting will depend upon the size of the society, the width of the delegation to the committee and the purpose to which the society has been incorporated.

We do note that it is quite likely that persons appointed on sub-committees may become officers of the society by reason of the width of the definition of "officer" in section 36 of the Bill. Given that the members of the sub-committee will have delegated management responsibilities, we are of the view that this is appropriate.

(10) 15 day appeal period - Clauses 185(1) and 187(1)

We agree with the Hui E! comment that 15 working days is a very short time period to organise an appeal to the High Court. It is very hard for a community organisation to gather material, meet, decide to lodge an appeal and lodge it within 15 days. As such we recommend this time period be extended, possibly doubled.

However, we have some difficulty agreeing with Hui E! with regards to a suitable alternative appeal process which would sit below the High Court. We do not believe that the District Court is the correct forum to hear appeals relating to an exercise of the Minister's or the Registrar's discretion. Potential solutions could involve establishing a tribunal or commission. However, we doubt whether there are resources to allow this.

We note that in the past there have been very few Registrar decisions and we are not aware of any appeals. The Bill may, however, require the greater exercise of the Registrar's discretion and powers. To date there has been little funding available for the Registrar to exercise powers and we would hope that, given the greater Registrar involvement envisaged in the Bill, further resources could be made available to the Registrar.

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These comments have been prepared by the Commercial Law Committee of the Auckland District Law Society Incorporated. Please contact the Secretary to the Committee, Ben Thomson ([ben.thomson@adls.org.nz](mailto:ben.thomson@adls.org.nz)) if you have any questions.