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Incorporated Societies Draft Bill Consultation
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PARK LEGAL LIMITED; SUBMISSIONS AND PUBLICATIONS – EXPOSURE DRAFT OF THE INCORPORATED SOCIETIES BILL

Dear Ministry of Business, Innovation & Employment (**MBIE**),

Park Legal Limited (**PL**) makes the following points in this submission on the Exposure Draft of the Incorporated Societies Bill (**DISB**). PL applauds MBIE's efforts to reform incorporated societies law and there are many aspects of MBIE's exposure draft that PL firmly endorses. These include the development of an effective disputes resolution framework and the creation of standard terms to aid societies in rule-writing.

However, PL has five major areas of concern with regard to the DISB. PL is concerned that:
1 – *the incorporation of duties from the Companies Act 1993 does not properly reflect the differences in the guiding principles of societies and companies;*
2 – *the duties in clauses 52 and 53 are not properly duties owed to the society;*
3 – *the number of members required to be registered is too many and should be further reduced;*
4 – *the Bill does not adequately reduce the likely cost of resolving legal disputes;* and
5 - *Clause 83 places an unnecessary burden on smaller incorporated societies.*

General Comments

Officers Duties, Financial Gain and the Companies Act

PL believes that officer's duties and restrictions on incorporated societies should reflect the principles of incorporated societies. MBIE has discussed the principles of incorporated societies given by the Law Commission (**LC**)[1] as being that incorporated societies:

1. are private bodies operated by their members;
2. should not distribute financial gain to members; and
3. should be free from *inappropriate* government interference.

Both MBIE and LC mention that the officer's duties proposed owe much to the regime of director's duties contained in the Companies Act 1993. The foundation

[1] Law Commission *A New Act for Incorporated Societies* (NZLC R129, 2013) at 34.

for those duties lies in LC's 1990 Report *Company Law: Reform & Management*. That report in discussing director's duties mentions the link between responsibility for directors to the concept of the company and the need to equate the company with the particular 'enterprise'[2]. It goes on to say that the "hierarchy of duties set up by the draft Act is… for the purposes of company law only"[3], recognising the particular relevance of these duties to the concept of the company. If a company can ensure its solvency without being put into liquidation by its creditors it can effectively wind itself up and distribute any profits from asset sales to its shareholders. Alternatively, if the company's problems can be solved and liquidity maintained this can ensure the opportunity for future profit to future shareholders. These are major reasons why directors owe a duty to the company avoid reckless trading and ensure solvency. LC mentions that it had misgivings about the necessity of imposing such duties on officers of incorporated societies[4]. LC particularly pointed out that where companies are in the business of profit, societies are by LC's own definition not interested in profit.

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There are some societies that do carry on major business operations, but many societies may only carry on business operations occasionally and on a very small scale. Without the need for shareholder protection, imposing such duties on small societies could have seriously damaging consequences to the volunteers involved in those societies. Elsewhere the LC has mentioned that many officers of charities do not understand their obligations[5]. This, PL would suggest, is more a function of the voluntary nature of the sector than an effect of any ambiguity in the law. It has been noted that directors of small and medium sized companies have great difficulty in interpreting the solvency test given the vast array of tasks for which they are responsible[6]. Officers of small societies often come to the management of these enterprises in their spare time and arguably have less time and energy to spend on understanding the solvency test.

In *New Zealand Netherlands Society "Oranje" Inc v Kuys* the Privy Council specifically noted that fiduciary duties around disclosure had different applications in different circumstances[7]. This was a recognition that the duties of officers do very much depend on the nature of the society. Some societies may be involved in ongoing business operations, others may only take such operations up infrequently and sometimes societies may resort to business operations in specifically to generate an income to pay expenses when they are otherwise in economic difficulty. Requiring a society, or its officers, to observe the solvency test for what may be the first time in such circumstances may be to doom a society to dissolution. The purpose of a society is not to make money for its members but to benefit wider society through the promulgation of its cause. It should be recognised that, occasionally, wider society, particularly creditors and particularly where debts are likely to be small, may be asked to pay a price

[2] Law Commission *Company Law: Reform and Restatement* (NZLC R9, 1989) at [194].
[3] At [195].
[4] *A New Act for Incorporated Societies*, above n 1, at 78 6.60.
[5] At 74 6.38.
[6] Andrea Bather "The Companies Act 1993 and Directors' Duties: Small and Medium Entities are not well catered for" (Working Paper Series, University of Waikato, Department of Accounting, 2006) at 21.
[7] *New Zealand Netherlands Society "Oranje" Inc v Kuys and the Windmill Post Ltd* [1973] 2 NZLR 163 (PC) at 3.

for the wider benefits societies bring to 'society'.

A. Officers Duties should be drafted generously where possible so as not to create a straight jacket on the function of small societies.
B. Where particularly strict duties are needed for societies operating major business operations restrictions on the application of such duties should be clearly stated in the Act.
C. Government bodies tasked with implementing the Act should be required to pay particular regard to the size and activities of the society in enforcing the law on officer's duties.

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Civil Society, Volunteerism and Cost Minimisation

PL believes that DISB should provide for cost effective compliance and dispute resolution procedures that reflect the nature of incorporated societies. MBIE, in stating that incorporated societies:

1. are private bodies operated by their members; and
2. ….
3. should be free from *inappropriate* government interference,

has recognised that incorporated societies have highly nuanced governance regimes and that those regimes should be allowed to work out processes internally where reasonable. The stress on freedom from inappropriate government interference places a burden on legislators to prove that regulatory interference is appropriate. This is arguably higher than a simple balance of probabilities standard as MBIE interference should be the exception to the norm of freedom. Freedom of association as articulated in s17 of the New Zealand Bill of Rights Act has a particular relevance to any government attempts to regulate incorporated societies. The legislative should therefore refrain from regulating in this area unless they can be sure that the burden of proof has been met. The issue of officer's duties and the solvency test is one area in which PL would argue that the burden has not been met, so far as LC has mentioned that it continues to have doubts as to the necessity of legislation. However, PL believes that this dynamic is not unique to the area of officer's duties.

The first other major area of concern for PL is the resolution of disputes that arise in incorporated societies. Given that there is often significant miscomprehension of the duties that officers owe and also due to the nature of societies, a great many disputes arise as to the governance of particular societies. MBIE has correctly provided in the DISB for the correct first venue for the resolution of such disputes to be the society itself (cl 24(1)(j)). However there are many circumstances where PL feels it would be unrealistic to expect societies to be able to resolve their disputes internally. In such circumstances, PL is concerned by the fact that many disputes will enter the judicial system at High Court level. For small societies without the funds to litigate at that level, this will often mean that disputes remain unresolved and the important civil society functions carried out by incorporated societies will not be maintained where societies are unable to access effective dispute resolution. This is because to implement the civil society causes that incorporated societies advocate, they need to have internal consensus about those causes. In addition many of the

disputes that arise within incorporated societies, and member's perceptions of those disputes, are highly nuanced and not suited to the adversarial black law approach of the higher courts. Instead it would be beneficial if a more mediative judicial approach, with a focus on the long term relationships between society members were available. The provision of a mediation service with aspects of that provided under the Employment Relations Act 2000 would be a more appropriate first step in the justice system for such disputes. Alternatively allowing such disputes to come before the Disputes Tribunal, or even a body with an adjudicative approach comparable to that found under the Construction Contracts Act 2002, is another possibility that might be considered. Overall, it is important to recognise that wider society has an interest in such disputes being effectively and cheaply resolved so that incorporated societies can carry out their civil society functions.

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The other major area of concern for PL is the accountability of incorporated societies to the executive branch of government. The function of civil society in general can often be to hold the executive branch to account through publicising injustices either directly to actors in the legislative branch, to the media, or to other individuals who can aid in bringing matters before the judiciary. As such, in principal, dangerous and inappropriate government interference in incorporated societies increases with the amount of oversight that the executive branch has over incorporated societies. Community Aotearoa has also pointed out that requiring incorporated societies to meet accounting standards may create a dis-incentive for groups to incorporate[8]. The first risk that this creates is that it is much harder to ensure the financial propriety of unincorporated societies. Secondly, the difficulty of operating an unincorporated society may cause individuals to eventually refrain from taking carrying out new and needed civil society functions. PL would like to see more a flexible and voluntary accounting standards regime granted to non-charitable small incorporated societies.

D. All regulation of incorporated societies should be tested on a strict standard of whether that regulation is a restriction appropriate to impose on the right to freedom of association.
E. Accountability to executive branch officers should also be kept to the minimum appropriate level.
F. External dispute resolution procedures provided under the Act should where possible avoid black letter adversarial adjudication and be based on an approach that repairs relationships between society members.
G. Societies should not have to bear financial reporting requirements that create disincentives to association or compliance; in particular MBIE should consider allowing financial reporting to be voluntary for small non-charitable societies.

Clause by Clause Comments

Clause 8

PL considers that requiring a society to have 10 members before it can

[8] Hui E! Community Aotearoa Incorporated "Incorporated Societies Bill – Exposure Draft: Consultative Seminar" (powerpoint slides to seminar delivered in Auckland on 4 May 2016) at 33.

incorporate is an arbitrary limit. PL notes that currently under if a society wishes to incorporate under the Charitable Trusts Act 1957 the signatures of only 5 members is required. To encourage the incorporation of societies so that they can better carry out their civil society function PL requests the clause be rewritten:

H. "*(1) Any 5 or more persons may, on an application under section 9, incorporate a society under this Act for any lawful purpose other than financial gain.*"

Clause 22

PL considers that great care should be taken to ensure that the definition of financial gain, and particularly of 'arm's length terms' be drafted so to only place such reasonable limits on freedom of association as can be demonstrably justified in a free and democratic society. PL considers the requirement to treat an interested member in an arm's length transaction as if he were not otherwise connected or related to the society duplicates the effect of later provisions and includes a test that in some circumstances may be difficult for societies to assess internally. PL also considers that societies may sometimes wish to run competitions with prizes to members that are not related to their purposes for the purpose of raising funds. PL considers that the requirement in 22(3)(g) that such benefits be incidental is protection enough against undue financial gain. PL requests the following amendments:

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I. "*22(5)(a)(i) would be reasonable in the circumstances if each party were acting independently, and each acting in its own interests; or*"

J. *"22(3)(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~~*"

Officers Duty Clauses Generally

PL recognises that it is important to state that officers of incorporated societies owe duties to their societies. PL considers that such duties should be framed in the understanding that:

i. many officers will not be familiar with legal terminology and formulae;
ii. many officers volunteer their time to take on these responsibilities as a duty to wider society and to their cause; and
iii. the need for minimal regulatory intervention in the operation of societies has been recognised as a core principle of their operation.

As such, PL believes that officers' duties should be clearly phrased in simple English, lenient and minimal. The burden of this lies as much with the Government agencies tasked with implementing observance of these duties and punishing infringements of them as it does with those that draft the Bill. PL considers it is not desirable to establish a strict criminal test on the observance of duties by those who, regardless of their adherence to those duties, carry out voluntary roles to the benefit of society generally. With regard to the text of the law PL considers that some officers will come to their responsibilities with a good idea of what the law expects whereas other officers will be ignorant of this. PL therefore requests that in order to protect the inexperienced officer who might unwittingly be a party to the breach of his duties, that the following addition be

made to clause 51:

K. *"51(d) the experience of the officer in the exercise of those or similar responsibilities."*

PL is concerned that the there may be situations where the society does not feel that an officer has breached his duties but that the Registrar may over-zealously apply the law. To protect against such situations PL requests that the following addition be made to clause 99:

L. "*99 (4) In deciding whether to apply the Registrar must pay particular attention to the society's opinion as to whether the officer has breached, or is likely to breach, the duty.*

PL also requests that particular attention be made to ensuring that:

M. The Registrar, in carrying out his duties under clause 99, should bear in mind that the civil society function of incorporated societies is undermined when society members are do not have a clear understanding of and fear the implementation of the law by the Registrar.

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Clauses Relating to Officers Financial Duties

Pl considers that duties relating to reckless trading and financial obligations are of particular relevance to societies that participate in a regular pattern of trading activity. However, there are many societies that do not partake in trading activities. These societies may irregularly turn to activities that might be classed as trading such as raffles, bake sales, or other minor money-making ventures for the purpose of fundraising. The officers of such societies may not be aware of the complex nature of many financial obligations and certainly could not be realistically expected to grasp the nature of the solvency test. PL considers that to penalise the officers of these societies in the same way as to penalise the officers of societies that regularly participate in trading activities would be an unfair burden. Such a burden might act as a disincentive to the establishment of smaller societies that fulfil important activities in smaller communities. Further, as discussed above, with regard to the differences between societies and companies, duties against reckless trading and in relation to obligations should not be owed to societies themselves. Instead, PL considers these duties are owed to society at large as part of the general undesirability of allowing obligations to be incurred without redress for those to whom the obligations are due. PL considers that it would be dangerous to describe the duties as owed directly to creditors and that it would be better to describe these duties as owed to the people of New Zealand. PL requests the following amendments:

N. ***"52 Reckless Trading or other activities***

An officer in a society that regularly, or in that particular accounting period, engages in trading activities of such a volume that it is not allowed to use cash accounting must not knowingly:

(a) agree to the activities of the society being carried on in a manner likely to create a substantial risk of serious loss to the society's creditors; or

(b) cause, or allow, the activities of the society to be carried on in a manner likely to create a substantial risk of serious loss to the

society's creditors."

O. *"**53 Duty in relation to obligations***

An officer in a society that regularly, or in that particular accounting period, engages in trading activities of such a volume that it is not allowed to use cash accounting must not knowingly agree to the society incurring an obligation unless the officer believes at that time on reasonable grounds that the society will be able to perform the obligation when it is required to do so.

P. *"**55 To whom Duties owed***

*The duties in **sections 48 to 51** are owed to the society (rather than to members). The duties in **sections 52 and 53** are owed to the people of New Zealand."*

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In concordance with the above points PL requests that the following amendment be made to clause 117:

Q. *"117(4) Every officer of a society that regularly, or in that particular accounting period, engages in trading activities of such a volume that it is not allowed to use cash accounting commits an offence if…."*

Clause 83

PL recognises the importance of high quality consistent reporting by societies with a large role in wider society. PL, however, considers that many smaller societies struggle with the law as it is and that imposing on them an excessive financial reporting standard creates a disincentive to incorporation. The incorporation of societies can often be of great value to small communities and their health as regards wider society. Financial reporting standards may be excessive where the assets or turnover of the society are negligible and where officers come from a background where they are unfamiliar with or unable to understand financial reporting standards in general. Imposing such standards on officers can create a disincentive to incorporation where English language fluency, funds, time and/or legal knowledge are not resources held by society members. PL therefore is concerned that a disproportionate burden will be borne by rural and ethnic minority communities should more difficult reporting standards be required of incorporated standards than those that are already the case.

R. Clause 83(2) should be altered to reflect standards no more stringent than those currently required under s23(1) and (4) of the current Incorporated Societies Act 1908.

Part 6 Subpart 2

PL applauds MBIE for its efforts to clarify the process of dispute resolution and to ensure that societies have measures to resolve their own disputes internally. The operation and governance of societies will often reflect the values of minorities that those societies represent. Those values should also be reflected in the resolution of internal disputes. The precedent nature of judicial decisions may have a disadvantageous effect where the expectations of societies based on minority values differ markedly from the expectations of wider society.

In addition, the adversarial nature of the judicial system is more likely to

accentuate than heal rifts between aggrieved members of a society. Societies often require a broad consensus to be able to bring motions to a vote. When the adversarial process of a court proceeding has run its course disputes solved between the immediate parties can grow to create wider rifts, accusations of blame or ill will between society members that undermine that broad consensus. The imposition of a distant decision uninformed by the nuances and values of the society can work to undermine the confidence, processes and cohesion of a society. PL considers it necessary that judicial intervention at the lowest levels needs to be that of a specialist body that is not inhibited by strict procedural requirements. Many of the statements made in s 143 of the Employment Relations Act 2000 express values and goals that are common to the resolution of disputes in societies. PL suggests that sections 144 – 155 of the Employment Relations Act 2000 create a regime that recognises the importance of maintaining the relationship between the parties, and the nuanced nature of relationships between some parties.

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Also, many societies will not have sufficient funds to effectively liquidate any matters that do require an adversarial approach at the level of the High Court.

PL requests that:

S. Clause 191 be amended to remove first jurisdiction for the matters in clause 191(a) from the High Court to the District Court.

T. New clauses be drafted to provide a conciliatory, nuanced and relational dispute resolution procedure based on ss 144 – 155 of the Employment Relations Act 2000 that would as much as possible pre-empt the jurisdiction of the District Court in clause 190.

Please contact us if you have any questions or queries regarding this submission.

Yours faithfully
PARK LEGAL

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