

NEWSLETTER

November/December 2003

PAYING DIVIDENDS – ARE YOU SOLVENT?

After the annual profit has been established at the end of each financial year, it is common commercial practice for companies to simply credit the profit share (dividend) to a current account in each shareholder's name. No cash leaves the company but the company's financial statements record a liability to pay out cash to the shareholder if and when demanded.

However, as a result of the recent case of *Kitchener Nominees Limited v James Products Limited*, shareholders can no longer access funds in the current account without potential future consequences if those dividends have simply been credited to the current account rather than actually "paid".

The rule governing payment of dividends is quite simple: directors can pay a dividend to shareholders, if at the time of the dividend the company satisfies a solvency test immediately after the payment. The *Kitchener* decision highlighted the fact that when "paying the dividend"

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the solvency test must be met on two separate occasions:

- When the decision is made to distribute annual profits, and
- At the time of actual payment.

If the dividend is credited to the shareholder's current account, actual payment does not occur until the shareholder demands payment of those funds from the company.

To pass the solvency test, companies must be able to pay their debts as they fall due (cash-flow test) and must have a positive net asset balance (balance-sheet test), after making the dividend. The commercial reality is that many New Zealand companies are woefully under-capitalised and struggle to pay dividends legally because the cash-flow test cannot be satisfied. Crediting the shareholder's current account may avoid cash from immediately leaving a company's coffers but directors must then reconsider company solvency when funds are taken from the current account at a later date.

The High Court held that the two requirements for the solvency test provide clear evidence that shareholders not be entitled to use their influence within a company to gain preference over outside creditors at a time when the company is insolvent.

As a result of the *Kitchener* decision, a shareholder may have difficulty obtaining the dividend from the current account where the company's solvency position has

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changed since the dividend was authorised. If unpaid dividends are paid out when the company is insolvent, the company (or a liquidator) may recover the benefits from the directors and shareholders.

Solution

The problem can be solved if the distribution is paid in cash to the shareholders. The shareholders (if they wish) can then put the money back into the company as loan advances. By doing so, the character of the money paid out has changed. Provided the company is solvent immediately after the funds are paid, the re-introduced funds can be treated as an advance. The company would not then be required to satisfy the solvency test every time funds were withdrawn from the current account.

It is clear that filtering company dividends through shareholder current accounts cannot be used to avoid the solvency test and prejudice creditors. Directors of small, private companies (and their accountants) must be careful with credits to shareholders' current accounts and the payments actually made to shareholders. They must ensure the solvency test is satisfied on both occasions otherwise the directors and shareholders may have to pay if the company is short of funds on a liquidation.

RELATIONSHIPS OF SHORT DURATION

The Property (Relationships) Act 1976 ("the Act") has been in place since February 2002 and the Courts are slowly gathering together a collection of decisions to guide practitioners and their clients through the new provisions and issues that were introduced.

An interesting case has come from the deepsouth dealing with relationships of short duration for unmarried partners (usually less than three years).

There is a distinction made between relationships of short duration between married and unmarried partners. For married partners, the Court will divide their relationship property according to the respective contributions to the relationship of each partner. For unmarried partners, the Court does not have jurisdiction to divide their property unless:

- There is a child of the relationship; or
- The applicant has made a substantial contribution to the relationship; and
- In either case, the Court is satisfied that the lack of an order will result in serious injustice.

The presence of a child or a substantial contribution will not necessarily be a reason for the Courts to find that serious injustice will result.

What is Needed?

For an application of this type, the Court will need detailed and specific information about the likely result and degree of injustice that would result if the Court refused to intervene.

Section 15 of the Act empowers the Court to award lump sum payments or transfer property to one party where 'economic disparity' exists. Economic disparity arises if, on the division of relationship property, the income and living standards of one partner are likely to be significantly higher than those of the other partner because of the effects of the division of functions or roles within the relationship.

The birth of a child may be the key to a successful application under section 15 if one parent is unable to pursue a career by having to assume the primary caring position. If the Court refuses to intervene it would, in effect, block any application under section 15 to address economic disparity. On the other hand, the Child Support Act 1991 could provide relief through availability of financial support.

A significant disparity in contributions may be sufficient for the Court to intervene. However, prior to the changes in the Act, de facto partners (who were not covered by the legislation) had to rely on arguments that a "constructive trust" had been established in order to be granted a share of the property, and that may still be the case. A "constructive trust" is created where a person made contributions to the other's property and had a reasonable expectation that he or she would receive a share of the property in return for the contributions.

In the case from the deep south the Judge stated that a combination of factors, each not necessarily in itself amounting to a serious injustice, might together add up to a serious injustice. Unfortunately for the applicant in this case, she failed to satisfy the serious injustice test, despite the birth of a child during the relationship.

We may have thought that with new legislation, many of the old principles and arguments would no longer apply. However, this decision emphasizes the many complexities of the old legislation and common law which have carried through.

BUILDING DISPUTES STILL A PROBLEM

In the aftermath of our "leaky buildings" fiasco, a revamped Building Bill ("Bill") was introduced to Parliament.

Submissions for proposed changes to the Bill closed on 15 October 2003. The Select Committees' response to submissions will be looked at with great interest. In particular, the Committee's response to aspects of the Bill that purportedly increase consumer protection will be scrutinised carefully especially in light of inadequacies of existing options available to consumers involved in building disputes.

The Bill Provides Some Protection

The Bill aims to encourage better building practices and improve the control of building design and construction. It aims to ensure buildings are designed and built correctly and that buildings meet the standards in the Building Code. Changes include further empowerment and increased involvement of the Building Industry Authority, greater regulation of building professionals and materials used in the construction process, and the introduction of implied statutory warranties into all building contracts.

The implied statutory warranties contained in the Bill provide an expansion of legal rights for consumers. However, the Bill does not provide a process by which consumers can easily enforce these rights.

Current Options - Less Than Satisfactory

The following options are presently available for resolution of building disputes:

1. Voluntary and private negotiation, facilitated mediation and/or arbitration;
2. The Disputes Tribunal for disputes involving amounts up to \$7,500 or up to \$12,000 with the agreement of both parties;
3. Construction Contracts Act (CCA) adjudication process for payment disputes between parties;
4. Weathertight Home Resolution Service for disputes concerning leaky buildings; and
5. The Courts for all disputes.

Each of these options has unsatisfactory points from a consumers' perspective.

The average consumer (especially when participating in negotiation or mediation) will have limited knowledge or experience as to how matters can or should be resolved.

Conversely, the other party may be very experienced, highly motivated to defend their position and in a more powerful position with respect to resources.

The effectiveness of the Disputes Tribunal is limited because:

- its jurisdiction is capped at a specific amount,
- the matters involved in building disputes are often of a complex, technical nature requiring expert opinion, and
- there is a potential multiplicity of parties.

The primary focus of the CCA adjudication process is to provide a quick means of dispute resolution between consumers, building contractors and sub-contractors over contract payments. The CCA process is only useful prior to payment being made, yet for most consumers the problems arise after payment has been made.

Court resolution can also be unsatisfactory as a building dispute generally involves the consumers' largest asset and the dispute is likely to arise at a time when cash reserves are limited. Pursuing disputes in court over matters involving less than \$50,000 is of little benefit. As with the disputes tribunal the court's effectiveness is limited by the potential multiplicity of parties and the need for technical specialists.

On This Point, Consumers Are No Better Off

Without a specific provision for a process for enforcement of the implied statutory warranties, consumers must still rely on existing options for dispute resolution. While the Bill may encourage better building practices, its lack of an effective adjudication process may restrict consumers' ability to enforce the new rights.

LANDLOCKED LAND

One way in which owners can have land lawfully taken from

them is under section 129B of the Property Law Act 1952. This section provides that access may be granted to an owner of landlocked land for the purpose of providing relief from lack of access. Obviously, to provide that relief the Court must make an order against the owner of the neighbouring land to allow access.

A piece of land is landlocked if there is no reasonable access to it. In the 1970s and 1980s it was more likely that reasonable access would not necessarily include vehicular access. In one 1980s case, the Judge commented that "vehicular access in Wellington is the exception rather than the rule ... what is required is that there should be adequate off-street parking".

What is Reasonable?

In a more recent 1994 case, however, the Judge held that while reasonable access did not invariably mean vehicular access, a determination should be made in light of current requirements and the general topography and nature of the area in question. In that case, vehicular access was granted.

The successful cases have generally arisen where there is "inadvertence or a historical accident". Typically access was available to the owner of the landlocked land through an informal arrangement and that access was subsequently denied. This is because the Court must have regard to the access that existed when the applicant purchased or otherwise acquired the land, or the circumstances in which the land became landlocked.

In *Kingfish Lodge (1993) v Archer* the applicant was the owner of a licensed tourist lodge which had existed since 1946 but was accessible only by sea. The owner had plans for redevelopment which required access by land through neighbouring farms. Negotiations with the owners of those farms had been unsuccessful. In that case it was held that the land was not landlocked. Physical access to the land did not necessarily require

vehicular access. For 46 years it had depended exclusively on sea access quite successfully and could therefore continue to do so.

In *Wentworth v Sayes*, however, the landlocked land was a valuable block at the bottom of a cliff facing the ocean. The land was part of a subdivision in 1962 in which the other blocks except for this one all had vehicular access. In 1994, application was made for vehicular access and that application was opposed by 23 defendants. The application was successful and the Judge noted that three acres of prime residential property necessarily requires vehicular access. "The idea of parking on the land above the cliff ... and walking down a track makes no sense".

While the application was not made by a property developer, there is a concern that property developers may abuse the grant of relief. Because in this case it would seem that a development opportunity was available to the owner, it raises concerns that property developers may take advantage of section 129B to develop landlocked land to the detriment of the owner who must grant access to it.

Although cases under section 129B arise fairly infrequently, it is not uncommon for practitioners to come across landlocked land from time to time. Generally, these matters can be resolved without recourse to the Court but relief may be available under s129B if required.

CONSUMER GUARANTEES – WHAT ARE YOUR RIGHTS?

The Consumer Guarantees Act 1993 ("CGA") applies to the supply of goods or services to consumers, and offers considerable rights and remedies in the case of faulty goods and/or inadequate services.

Who Does it Protect?

The CGA applies to any supply of goods or services to a consumer. A

consumer is anyone acquiring goods or services of a kind ordinarily acquired for personal, domestic or household use or consumption (except where goods are purchased for re-supplying in trade, using to manufacture or process goods or to repair in trade other goods or fixtures on land).

If you acquire goods or services of a type ordinarily acquired for personal, domestic or household use, you are a consumer (even if you purchased the goods or services for business purposes), and the CGA applies.

Contracting Out?

You can contract out of the CGA only when supplying to a business. If you have not contracted out, the CGA will apply to the purchase of the office computer, work vehicle or tearoom microwave.

What Rights Do You Have?

The CGA implies a number of guarantees into the provision of goods or services, including:

- The seller has the right to sell the goods.
- The goods are of an acceptable quality.
- The services are provided with reasonable care and skill.
- The goods or services are fit for the consumer's purpose for acquiring them, (where the consumer has expressly or impliedly made the purpose known) or any purpose represented by the seller.
- The goods comply with any description and/or sample supplied.
- The goods or services are supplied at a reasonable price, and services provided in reasonable time (if not already agreed).
- The repairs and spare parts are available.

Is the Price Right?

Where a price has not been previously agreed for goods or services, a consumer does not need to pay more than a reasonable price. If the price has not been discussed, a consumer can order goods from a supplier, without the fear that the supplier will charge more than what is reasonable for those goods.

How Long Should You Wait?

A common complaint is that the time of delivery of goods or services does not meet a customer's expectations. Under the CGA, goods must be provided, and services completed, within a reasonable period of time.

Repercussions

Where there has been a minor breach or defect, the supplier may elect to either repair, replace or refund the goods, or rectify the services. If this remedy is not completed within a reasonable period of time, the consumer can reject the goods, and in the case of services, either cancel the contract, or have the failure remedied elsewhere and recover all reasonable costs involved.

Where there is a substantial defect, the consumer can either have the goods replaced, or demand a refund. In the case of services, the consumer can cancel the contract or obtain damages for any reduction in value.

A consumer can also obtain damages for any reasonably foreseeable losses. These can include the cost of reinstalling goods, restoration of premises, loss of use of goods, emotional stress, loss of wages, and business losses (where the supplier has not contracted out of the CGA). If you are a business, the cost of non-compliance under the CGA can be very high – make sure you comply! Talk to us if you need assistance.

If you have any questions about the newsletter items please contact us, we're only too happy to help.