Horrocks Hampton LAWYERS

NEWSLETTER

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New Disclosure Obligations for Investment Advisers & Brokers

Over the past 6 months, eighteen finance companies have either failed completely or run into trouble. So it should be comforting to know that the Government has indicated a willingness to legislate to protect the public by passing into law the Securities Markets (Investment Advisers and Brokers) Regulations 2007 (the "Regulations").

The Regulations supplement and update the Securities Markets Amendment Act 2006. Commencement Order SR 2007/367 provided for the Amendment Act to come into force on 29 February 2008, the same day as the Regulations. They are now either contained in or read together with the Securities Markets Act 1988 ("the Act").

Intention of the changes

The intention of the amendments and regulations is to oblige Investment Advisers and Brokers to make certain disclosures to clients in a prescribed manner before giving investment advice or providing services as an Investment Adviser or Broker.

What must be disclosed?

An Investment Adviser must disclose in writing, in the manner prescribed, the following:

- experience and qualifications
- criminal convictions and adverse findings in any Court on their professional role
- the nature and level of any fees charged
- details of remuneration or awards they received or will receive from anyone else
- other interests and relationships that could affect the advice

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- types of securities they advise on

It is important to note that clients do not have to ask for this information; it must be provided up-front.

Who is an Investment Adviser or Broker?
An Investment Adviser gives recommendations, opinions or guidance relating to investment in securities to members of the public in the course of the adviser's business or employment. Certain information will not constitute advice, such as opinions published in the media, assistance with acquiring and disposing of securities, and offer documents including a registered prospectus and authorised advertisements.

An Investment Broker receives investment money or property from members of the public in the ordinary course of their business. Therefore, the definition of an Investment Adviser or Broker can include share brokers, financial planners, accountants, lawyers and others that give investment advice to the public.

One point that will be of real interest is the requirement for Investment Advisers and Brokers to disclose their commission structure and the amounts before advice is given. That includes all remuneration whether direct or indirect, that the Adviser or Broker may receive following the giving of advice.

Criticisms
The regulations have been criticised for not going far enough as Advisers and Brokers are not required to give advice about the nature and quality of the investment and the client is not required to sign any agreement or receive any warning about associated risks. Furthermore, the regulations do not provide for a declaration of any conflict of interest and a consequent prohibition if a conflict does arise.

It has been suggested that a client agreement should be introduced that clearly sets out the risk associated with the investment being considered. It has also been argued that because a person's life savings may be at stake, the Government should consider passing more comprehensive laws requiring Advisers to fully apprise unsuspecting investors of the risks being taken and make it part of the Investment Adviser's job to assess the client's situation and make a recommendation based on that. Legislation aimed at ensuring that the risk is understood could be the next step.

Remedies
An Investment Adviser or Broker who fails to disclose in accordance with the Act commits an offence, and may be liable for a maximum fine of $100,000 for an individual and $300,000 for a body corporate. However, the Investment Adviser or Broker has a potential defence if he or she believed on reasonable grounds that the disclosure given was not deceptive, misleading, or confusing.

It is hoped that these changes go some way towards increasing transparency and reducing the types of losses we have seen recently.

Contracting with Young People – The Minors Contracts Act 1969

"Our aim is to have you in better financial shape after you borrow from us – not poorer". This statement appears on the website of Wine Country Credit Union (WCCU). It was certainly relevant in the case of two young people, R and T. According to the presiding Judge, during May 2003 R saw a car he liked and he "just had to have that car." So R and T borrowed $15,612 from WCCU, and they bought the car. However, within weeks R was apprehended whilst driving without a licence and the Police impounded the car. It was subsequently repossessed by WCCU and resold, leaving a balance owing of $12,000.

As a result WCCU sued R and T for the balance. However, a District Court Judge held that R and T did not have to pay any of the $12,000. WCCU appealed, but the High Court agreed with the District Court that R and T did not have to repay their debt. This was essentially because they were minors when they borrowed the money; R was 17 years, 9 months and T was 17 years, 6 months.

The Law
The Minors Contract Act 1969 provides that a contract with someone under 18 years of age is presumed to be unenforceable against that person. There are several important qualifications to that

rule. Firstly, certain contracts are excluded, such as some contracts for life insurance and some employment contracts. Secondly, a Court may enforce the contract against the minor in whole or in part if it concludes that the contract was fair and reasonable in all the circumstances. In the present case, the Court found WCCU could not enforce the loan contract and recover any of its money because R and T had not deliberately misled WCCU about their ages. They had correctly recorded their dates of birth on the application form but an employee of WCCU had miscalculated their ages to be 18.

If WCCU had made reasonable inquiries of R and T it would, in addition to establishing their ages, have also easily discovered that R and T:

- had only known each other for three weeks
- were employed in seasonal part-time work
- had overstated their income, and
- couldn't afford the repayments.

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Both Judges concluded that WCCU was careless and ought to have made more inquiries. In all the circumstances the contract was not fair and reasonable and, accordingly, the contract was unenforceable against R and T.

Conclusion

It was 20 years after the passing of the Minors Contract Act 1969 before there was a reported decision of the High Court concerning enforcement of a contract against a minor. A further 20 years has passed and the High Court has confirmed the basic principle, which is that generally contracts with minors under 18 are presumed to be unenforceable against the minor unless the other party can satisfy a Court that in all the circumstances the contract is fair and reasonable and ought to be enforced.

The WCCU employee's error in miscalculating R and T's ages and failure to question them about fundamental aspects of their application led to WCCU losing $12,000 of a loan on top of incurring the costs of litigation. The case highlights the need to check the age of a young person you are contracting with and to be aware that if they are under 18 the contract may not be enforceable against them.

Are You in a De Facto Relationship?

The inclusion of de facto relationships, (which encompasses same sex relationships) within the Property (Relationships) Act 1976 ("the Act") effectively means de facto couples will receive similar treatment, concerning disputes about property, to those who are married.

De facto relationships and the Act

De facto relationships will ordinarily be covered by the Act only if the partners have lived together as a couple for three or more years. After three years, the principle of equal sharing applies.

There are exceptions to the three year rule. These include situations where there is a child of the de facto relationship or where one party has made a "substantial contribution" to the de facto relationship. Before it makes an order, when considering exceptions to the rule, the Court must be satisfied that failure to make an order would result in a serious injustice.

Definition of a de facto relationship

Section 2D (1) of the Act defines a de facto relationship as a relationship between two persons whether they be a man and a woman or same sex partners; provided both are aged 18 or older, live together as a couple and are not married to or in a civil union with each other.

What constitutes living together as a couple?

Section 2D (2) of the Act states that when determining whether two persons live together as a couple, all the circumstances of the relationship are to be taken into account, including any of the following matters that are relevant in a particular case:

- the duration of the relationship
- the nature and extent of common residence
- whether or not a sexual relationship exists
- the degree of financial dependence or interdependence, and any arrangements for financial support between the parties
- the ownership, use and acquisition of property
- the degree of mutual commitment to a shared life
- the care and support of children
- the performance of household duties
- the reputation and public aspects of the relationship

The overall question for the Court is whether the two people concerned *live together as a couple.* The above list is not intended to be exhaustive, and any other relevant factors may be taken into account. Similarly, none of the factors is either independently, or in combination, a necessary ingredient of a de facto relationship. The factors set out above simply assist the Court in determining whether a de facto relationship exists.

It appears the Court is looking for a mutual commitment to a single lifestyle, with or without a common residence or sexual relationship. The Court will also be giving active consideration to the intention of the parties at 'relevant times', ('relevant times' will vary from case to case, but essentially encompass the series of events being considered by the judge) to enter into and to remain in a committed de facto relationship.

Limited Partnerships Act 2008

The Limited Partnerships Act 2008 ("the Act") came into force on 2 May 2008 and replaces the 'Special Partnerships' regime that existed under Part 2 of the Partnerships Act 1908. The Act establishes a new regulatory and tax regime in New Zealand for limited partnerships which removes barriers to foreign investment capital and promotes growth in New Zealand venture capital and private equity industries.

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There are several key features of Limited Partnerships under the Act.

- They are a separate legal entity. A limited partnership must have at least one general partner and one limited partner and they cannot be the same person. A partner may be a person, a partnership or a body corporate.
- They have two types of partners – 'general partners' who are liable for all the debts and liabilities of the partnership and 'limited partners' whose liability is limited to the extent of their investment or capital contribution to the partnership.
- The limited liability is retained only so long as the limited partner does not engage in the day to day management of the partnership. The limited partner is only allowed to participate in what is referred to as 'safe harbour activities' such as key decisions on how the partnership is run but not day to day management. A complete list of 'safe harbour activities' can be found in the Act.
- Limited Partnerships will have 'flow-through' tax status, meaning that each partner will be taxed individually at that partner's personal tax rate rather than the partnership being taxed as a whole.
- Limited Partnerships will be required to have a written partnership agreement that will cover such areas as entry to and exit from the limited partnership, entitlement to distributions and assignment of interests, and
- Limited Partnerships will continue indefinitely rather than having a set life span.

The Companies Office will administer the Limited Partnerships Act and will provide a searchable register of New Zealand Limited Partnerships, and Overseas Limited Partnerships that are conducting business or are engaged in business activities in New Zealand. The Ministry of Economic Development states that the register will go live on the internet in May 2008 and will be available 24 hours a day, seven days a week.

In recognition of the fact that a limited partner may not wish to have their interest in a Partnership disclosed to the public, information on limited partners will be treated as confidential on the register and will not be available to the public. The register must be kept up to date and there are strict time requirements regarding updating some information. Each year an annual return must be filed.

Limited partnership regimes can be found in countries such as Australia, the United Kingdom, Canada, Singapore and the United States and are a preferred structure for investing in venture capital. It is anticipated that the new Act will allow New Zealand businesses to compete internationally for these funds, which are often required for new companies and for early stage expansion.

Snippets

Charities Act Update

Charities are reminded that in order to retain or obtain charitable-purpose tax exemptions, they must register with the Charities Commission by 1 July 2008. The Charities Commission is currently processing applications from November/December 2007. Therefore, later applications for charitable status may not be processed by 1 July 2008. However, the Commission does have the power to backdate an organisation's charitable entity status to the date it received the properly completed application. Tax benefits can be claimed provided an application is received prior to 1 July 2008.

An application to the Commission involves completing the prescribed application forms and providing a certified copy of the rules of the charity. Registering a charity is often not straightforward. Therefore, legal advice is recommended.

Taser Update

The New Zealand Police are strongly in favour of Tasers being introduced, following the end of their trial last year. But controversy surrounding the Taser continues. An article entitled "Think Twice About Tasers", released by the Auckland District Law Society, cautions against a hasty implementation of the Taser and considers that strict guidelines need to be in place to prevent the Police from developing a casual attitude towards its use.

The introduction of the Taser will also have wider implications for New Zealand in terms of compliance with the Bill of Rights Act and International Law obligations. The Law Society has suggested that the final decision should be made by an independent body with provision for the public to make submissions.

If you have any questions about the newsletter items, please contact us, we are here to help

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