THE NEW ZEALAND
LAW
JOURNAL
PUBLISHED BY BUTTERWORTHS MARCH 1999

# THE LAW OF ARREST

The law of arrest is a mess. The extent of that mess is illustrated both by the Court of Appeal decision in *Nguyen* and in the subsequent comment, most of which was not well informed.

The decision in that case related to arrest by a private citizen, but the law relating to arrest by police is in just as much of a mess.

Nor are any of these concerns new. In 1992 the Law Commission held a seminar on its proposed code for regulating police questioning and detention and many of these issues were discussed then. In attendance were members of the Justice and Law Reform Select Committee.

Nothing has happened since, in part, it must be said, because any sensible proposal meets the opposition of the criminal defence lobby and the Law Commission at the time was patently unwilling to stand up to that lobby.

First, arrest by private citizens. The decision in *Nguyen* concerned the failure of shop staff to accord Bill of Rights Act rights to the person detained. The Court of Appeal examined the Crimes Act as it has stood since 1961 and pointed out that the explicit statutory powers of arrest had been removed, save when a constable is calling upon members of the public for assistance. Instead the Crimes Act effectively gives an indemnity from civil and criminal action to citizens who arrest in certain circumstances.

This leads to both conceptual and practical problems. The conceptual problem is that the feature that distinguishes arrest from assault is that one is the exercise of legal authority and so it is hard to see how what a citizen has done can be an "arrest" if there is no such authority. The practical problem is that, as pointed out in the Criminal Practice section in last month's *Journal*, the subject of arrest cannot presumably commit the offence of assault with intent to resist arrest, but will be able to commit offences such as assault with intent to injure.

But if the Court of Appeal had decided that the Crimes Act did confer a power of arrest, then members of the general public would be saddled with responsibilities under the Bill of Rights Act. The only practical consequences of this would be that cases would be pushed out by another half day on legal aid and that public spirited citizens would come away from the trial feeling that they had been the ones on trial and that they had been made to look foolish.

Nor would this accord with the purpose of the Bill of Rights Act, to protect citizens from the organised and potentially oppressive power of the state, rather than to interfere with the intuitive inter-actions of citizens.

Arrest by police is equally messy. Two conflicting sections of the Crimes Act led to the traditional view in New Zealand and in most states of Australia, that arrest had to be followed promptly by charge. Under the Judges Rules therefore, no further questioning was possible after arrest. This turned arrest into a mere formality after someone had been detained for some time for questioning.

Once the Bill of Rights Act became effective, the Courts realised that it was not doing the job intended, since the habit of deferring arrest for as long as possible defeated the purpose of the protections given by the Bill of Rights. Hence the Court of Appeal invented "de facto" arrest. This again is both conceptually and practically problematic. This was inevitable however, given the decision to enact a vacuous Bill of Rights rather than a clear set of instructions to police on dealing with suspects.

The truth that has to be grasped is that it is impossible to regulate and supervise police questioning of suspects unless police are given a clear power to arrest for the purpose of questioning. Only then is it possible to delineate the legal status of a suspect at any time and to lay down clear rules about questioning.

Unfortunately, the response of the criminal defence lobby is to huff and puff and protest that this offends some fundamental principle. The fact is, of course, that their clients are far worse off in the Police station under the current regime than they would be under one which clearly laid down the rules for questioning. The only beneficiaries of the current system are those who are unmeritoriously discharged from Court because police failed to meet a requirement no one had told them about and the lawyers who receive extra legal aid payments for arguing irrelevancies.

The Law Commission's 1992 proposals need to be revisited, in their original form, not as they became after the Law Commission backed down before the criminal defence lobby. That lobby actually succeeded, amongst other things, in having any power to prevent access to a particular lawyer removed, at a time when a high profile criminal case was under way involving a lawyer as one of the defendants accused of conspiracy and fraud.

The real excitement is that raising such questions inevitably raises the right to silence. This causes the outpouring of more huffery from those who have a financial interest in prolonging and complicating trials. There is no intellectually respectable argument for the right to silence, as was ably demonstrated in a paper by Thomas J and by the weakness of the Law Commission arguments for maintaining it.

So the problems are not new, the solutions are not new. All that is required is some intestinal fortitude. ❑

# LETTERS

## FROM MR BRIAN HENRY

Reading the editorial penned by Bernard Robertson in the editorial of 12 December 1998 and earlier editorials that he has written, it is tempting to conclude that he has political views, to quote an un-named legal colleague, "to the right of the round table". It is a safe assumption that he is a supporter of the tax avoidance industry – an industry in recent times I have apparently upset by my temerity in acting for the Right Honourable Winston Peters MP. Such is the effectiveness of my representations for my client that I have now become the subject of his pen, this to me one of the ultimate accolades as a counsel representing a client whose views are contrary to Bernard Robertson's.

I have an interesting parallel from when I argued *In re Wairarapa Electoral Petition* [1988] 2 NZLR 74 in which I raised the ire of persons with other political philosophies by deigning to represent Wyatt Creech, then a National Party candidate who had failed to win his seat by one vote. I can recollect many criticisms such as "who cares", "its of no significance" all of these people are blinded by their own interest. A counsel represents his or her client and if they have an interest in the prosecution of a case then counsel has a duty to unfailingly pursue that client's interests. The complete answer to those criticisms was that my client, the Honourable Wyatt Creech, is now the Deputy Prime Minister.

The article reveals the need by the author to protect and apologise for the tax avoidance industry and I am somewhat amazed that the editor of the *New Zealand Law Journal* should criticise the Right Honourable Justice Thomas for referring to the decision of *Commissioner of Inland Revenue v McGuckian* [1997] 3 All ER 817 but failing to mention the "criticism" of Lord Cooke and Lord Steyn. After all five Law Lords determined in that decision that the UK revenue should disregard artificial steps in a composite transaction inserted for the purpose of obtaining a tax advantage. The New Zealand Court of Appeal in *Re a Taxpayer* CA 96/96, 28 August 1997 Tipping J fully accepted *McGuckian* applied to cases of alleged "avoidance" (see p 15). This Court of Appeal was under the presidency of the Right Honourable Sir Ivor Richardson, the pre-eminent tax authority of this country. There was no criticism of *McGuckian*.

There being no judicial criticism, it must be that the learned editor of the *New Zealand Law Journal* is referring to the writings of tax academics and tax experts. The only problem that these commentators have is that the words of the Right Honourable Justice Thomas in the Court of Appeal is the law in New Zealand and no matter how many critical articles are written, *McGuckian* in the words of Lord Cooke has always been the law in New Zealand.

So far as the attack on my advocacy is concerned I will say only this: I expect and ignore this type of commentary from the sensationalist media but when the editor of the *New Zealand Law Journal* shows no understanding of the law I am left wondering as to the future of the profession in New Zealand. No doubt it can be argued that it was my failings as an advocate that led Sir Ronald Davison to write the report in the way that he did, but it must be remembered when counsel takes a case to Court it is not the quality or lack of quality of his or her advocacy that renders justice to the parties but it is the independence and courage of the Bench to ensure that justice is done. On the case of *Peters v Davison* CA 72/98, 17 November 1998 I am pleased to report that the Court of Appeal panel of five Judges unanimously decided what was the justice of the case. Beside their legal statute I am but a humble counsel whose client is in their debt.

To the legal team that has assisted me to date, including the late Martin Finlay QC, I give my thanks.

**Brian Henry**
**Barrister**

## "ECSTASY" AND CONFUSION

I read with interest the article by Michael Webb in the December edition of the *Journal* rejecting recent calls to reclassify "Ecstasy" as a Class A controlled drug. Whilst not wishing to engage in that debate directly, I wish to point out a number of areas of confusion regarding "Ecstasy".

"Ecstasy" is the street name for a drug and, as such, does not have a precise definition. It is generally taken to refer to 3,4-methylenedioxymethylamphetamine, commonly abbreviated to MDMA. MDMA is a psychoactive drug (meaning that it affects mood, perception, thought processes and consciousness) although at higher doses the stimulant properties characteristic of the simple amphetamines become more pronounced. It is similar in chemical structure and in many of its effects to methylenedioxyamphetamine (commonly abbreviated to MDA) and methylenedioxyethylamphetamine (commonly abbreviated to MDEA). These drugs are sometimes referred to as the "Ecstasy class" of drugs and are part of the "rave" dance scene. In my opinion the health risks associated with these drugs are similar and it is appropriate that they be treated in a similar way in legislation.

MDA is currently classified as a Class A controlled drug, MDMA as a Class B controlled drug and MDEA a Class C controlled drug (under the controlled drug analogue provisions) of the NZ Misuse of Drugs Act.

The confusion does not end there. The chemical structures of these drugs are such that they can be readily modified in quite subtle ways and many of the modified substances are also psychoactive. These chemically modified substances, often referred to as "designer drugs", may not be distinguishable to the casual user from more familiar substances. Thus those dealing in and/or using "Ecstasy" may not, in fact, be handling MDMA at all. One such drug which has been identified by ESR in several samples collected by police in NZ is N-methyl – 1-(3,4-methylene-dioxyphenyl)-

2-butanamine, commonly referred to as MBDB. MBDB is considered to be covered by the controlled drug analogue legislation and is thus classified as a Class C controlled drug.

It is also worth noting that "Ecstasy" tablets analysed by ESR have included bogus tablets and a small number which have contained other drugs as well as, or instead of amphetamine derivatives. These adulterant drugs have included ketamine and tiletamine, both veterinary medicines.

Finally, various stories are uncritically presented in our news media based on overseas reports. A number of recent references have been made to a "new, lethal designer drug ... stronger than Ecstasy" known as "DOB". "DOB" is well known in Australasia as 4-bromo-2,5-dimethoxyamphetamine or Bromo-DMA, and was relatively widely available in NZ in the early 1980s. Unlike the "Ecstasy class" of drugs DOB/Bromo-DMA is a hallucinogen and is closer to LSD in its effects than to MDMA. It is a Class A controlled drug and the relevant entry in the schedules to the Act was amended from 4-bromo-2,5-dimethoxyamphetamine to DOB in the Misuse of Drugs Amendment Act 1996.

**Keith Bedford**
**Forensic Programme Manager**
**ESR**

---

## PUTTING CHILDREN FIRST

I was interested to read in the December 1998 issue of your Journal the article, "*Putting Children First*" by Mr Christopher Sharp, Barrister, of England, in which he "reviews family law with no 'custody' or 'access' disputes".

Those of your readers who also subscribe to the *Butterworths Family Law Journal* will know that in the December 1995 issue you published an article by me with the title "*The Case for Change: 'parental responsibility' not 'custody' and access*" ((1995) 1 BFLJ 263).

As I said in *Director-General of Social Welfare v R* (1997) 16 FRNZ 357, that article –

> bemoaned the fact that the Children Act 1989 (UK) and the then intended amendment to the Australian Family Law legislation had done away with the traditional terminology while New Zealand was lagging behind, being left with concepts of custody and access as they are defined in the [Guardianship] 1968 Act.

I went on to say that my plea for change appeared to have fallen on deaf ears. As far as I am aware, there has been only one publication which has supported a change in terminology. In her dissertation as a part of her requirements for the degree of Bachelor of Laws (Honours), "*Seen, But Not Heard – Children and the legal decision making processes concerning parental separation and divorce*" (1998), Ms Nicola Taylor of the University of Otago said this at p 52:

> Despite the geographical proximity of Australia to New Zealand, and the common legal heritage we share with both England and Australia, it is surprising that their family law measures have not been the subject of prominent debate in our legal literature,

Although it should be noted that the English statutory regime and practice prior to the enactment of the Children Act were different from those which currently prevail in New Zealand, it is encouraging to read that the Act "has succeeded in reducing the number of unnecessary disputes". Notwithstanding that difference, I believe that the case for change in this country is as strong now as it ever was.

I shall not repeat the arguments advanced by me in my article but my experience presiding in the Family Court continues to convince me that to go on speaking in terms of "custody" and "access" is unhelpful and has the tendency to prolong parental disputes. Of course, a mere change in terminology will not be a cure-all (some initial Australian research tends to confirm that); an attitudinal shift is required. However, I believe that a greater emphasis on parental responsibility and a sharing of care and upbringing will assist in that shift and thereby in the resolution of disputes which take such a toll on the emotional and financial reserves of separated parents and which contribute so much to the cost of litigation in the Family Court, much of which is funded through legal aid.

It is also important to observe that a change in emphasis will give greater recognition to the principles set out in the United Nations Convention on the Rights of the Child 1989, in particular in arts 5 and 18.1, speaking as they do of the responsibilities of parents.

Perhaps now that there has been further discussion of this topic, the issue will come to the notice of those who have the will and the power to initiate change ....

**P von Dadelszen**
**Family Court Judge**

---

# VISIT BY EUROPEAN EXPERT ON CONSUMER LAW

Professor Geraint Howells, of the University of Sheffield, UK is a world authority on consumer law. He will visit New Zealand this month. Professor Howells is a prolific publisher of books and articles on consumer law, holds several legal periodical editorships and acts a consultant to the Commission of the European Communities on consumer law matters.

While here to conduct his own research, he will also give two lectures. On Thursday 18 March, Professor Howells will speak in Auckland and on Monday 22 March in Wellington. The title of the talk in each case is "The modern character of consumer protection laws".

The Auckland lecture is at the Sheraton Hotel and the Wellington lecture at the Plaza International. Both are breakfast functions.

For further details, or to register for either lecture please contact Des Pitfield at The Open Polytechnic of New Zealand on:

04-560 5716 or
pitdes@topnz.ac.nz

# DNZB IV

*Pat Downey*

### *reviews the latest volume covering 1921-1940*

*The Dictionary of New Zealand Biography*: Vol 4, 1921 – 1940, Edited by Claudia Orange, AUP.

Here is another volume of that outstanding work *The Dictionary of New Zealand Biography*. As with the earlier volumes, I could not resist looking at the first and last entries. We begin with Richard Abbott (1883-1954) an architect, and finish with Adela Mary Younghusband (1878-1969) an artist. These two entries indicate clearly that the work is not restricted to politicians and other such establishment worthies. The net is cast widely; but this too raises its own problems of 1990s political correctness as a principle of selection. I have remarked critically on this when reviewing the earlier volumes (see [1990] NZLJ 221, [1995] NZLJ 309, and [1997] NZLJ 199).

One of the many excellent features of this work is the Categories Index going from Armed Forces to Visual Arts and Crafts. So one can look up Law and Law Enforcement and read the biographies of all 58 listed – but then one notices that several of them are listed twice under different sub-headings like Judge and Lawyer, or Police Commissioner and Policeman. Interestingly three of the ten Judges do not make the list of Lawyers! Frank Acheson was a land purchase officer who became a Judge of the Native Land Court, and Arthur Tyndall a public servant who became a Judge of the Court of Arbitration.

The third one is surprising though. John Hector Luxford did practise in Te Awamutu, Hamilton and Auckland, before becoming a Stipendiary Magistrate in which role I remember seeing him sitting when I was a law clerk. Oddly he is not listed as a Magistrate, as John Barton is, but as a Judge. This is because he was for five years Chief Judge of Western Samoa. This was during the Mau struggle for self-determination. I would have expected him to have been listed additionally under the sub-heading Lawyer and Magistrate. He later became Mayor of Auckland, and is appropriately listed as a local body politician. The entry on him by Judith Bassett is exemplary in being critically sympathetic.

There are two Chief Justices noticed, Sir Michael Myers and Sir Humphrey O'Leary. These two very different personalities were partners for a short period (1918-1922) in the Wellington firm of Bell, Gully, Bell and Myers. An amusing aside recounted is that O'Leary in practice always employed male shorthand typists one of whom was H R C (later Sir Richard) Wild who himself became Chief Justice in due course. Other Supreme Court Judges included are Sir Henry Ostler and Sir David Smith. There is also an essay on the notable Attorney-General H G R Mason.

Somewhat surprisingly for a volume relating to the years 1921-1940 there is a biography of one President of the permanent Court of Appeal, Sir Alexander Turner. This Court was not established until 1958. By 1940 Sir Alexander was a leading lawyer and was also active in university education. He did not however become a QC until 1952, and a Supreme Court Judge in 1953. Sir Alexander's call to the Inner Bar had an odd historical footnote. His warrant, along with those of H P Richmond and L P Leary appointed them as King's Counsel, but the King having died the day before, they were called as Queen's Counsel. They would have been the first Queen's Counsel of the new reign. After all the sun rises first in New Zealand. Sir Alexander took a certain pleasure in telling the story. If my memory serves me rightly Sir Alexander was an occasional leader-writer for the *New Zealand Herald* in the 1930s and 1940s although this is not referred to in the essay about him.

Mentioning Sir Alexander Turner brings up what is for me a particular interest in this volume as it will be for others of my age group. There are many people written about whom I knew personally. I do not mean I knew them well, with the exception of Sir Alexander Turner in his later years at Butterworths. They were people of an earlier generation who I met and talked with in various circumstances as a young man. They were only occasional acquaintances and most of them would not have remembered me for very long, but for me of course it was different.

I made a list that surprised me by its length. To give only a selection there were the great and important people like Frank Sargeson, James Michael Liston, Rex Fairburn and Rewi Alley who I visited at his home much later in Peking. There were university people like James Rutherford, Willis Airey and Winston Rhodes along with writers like the great poet but tortured personality R A K Mason, and the journalist Pat Lawlor. What I found interesting about all of these was to read the summation of their lives and the assessment of their characters, and to compare this with the awe I felt for them when I was so much their junior. Reading about them after all these years I found an interesting experience. My assessment of some of them, even now, would not be quite the same as the authors of the short biographies. When the next volume is published, there will be a large number of people I knew better; and my reactions will I suppose be more complicated.

The sheer variety of people whose biographies are set out makes this new volume as interesting to read – well, skip around in – as the earlier volumes. The criticisms I have made in previous reviews about the selection process I think are still valid. The selection is however a wide and fascinating one, including Prime Ministers Savage, Fraser and Nash; Police Commissioners Denis and James Cummings; criminal (!) John A Lee; poet Eileen Duggan; charlatan Abraham Salaman; runner Jack Lovelock; broadcaster Maud Ruby Basham (Aunt Daisy); cartoonists Lowe and Minhinnick; actress Maria Dronke; administrator Bernard Ashwin; and teacher and novelist Mary Jane Mander. Just to list these names rather arbitrarily gives some flavour of the interest, enjoyment and satisfaction to be had from this fourth volume of what is undeniably a major work of New Zealand historiography. ❑

# RAIDERS OF THE LOST ARCIC

*Michael Sloan and Sarah Plumley, Simpson Grierson, Wellington*

*discuss the new Accident Insurance Act*

## INTRODUCTION

Accident compensation has had a great deal of attention in Parliament, the Courts and the media over the last few months. The Court of Appeal has allowed those suffering mental injuries to sue for exemplary damages (*Queenstown Lakes District Council v Palmer* CA 83/98). Parliament has passed legislation to enable sexual abuse victims to sue for exemplary damages (Quigley Amendment to the Government Accident Insurance Bill). The Accident Insurance Act has also been passed. Each of these have attracted interest and debate. This article centres on the new Accident Insurance Act (the "Act"). The Act seeks to introduce competition into the provision of accident compensation insurance.

The proponents of the Act assert that competition will improve incentives for employers to minimise the cost of injuries to society. They point out ARCIC's expenditure has increased at an average annual real rate of eight per cent since 1985.

Opponents argue that the original Woodhouse principles of community responsibility, comprehensive entitlement, complete rehabilitation, real compensation and administrative efficiency, should be adhered to. They contend that these objectives are most efficiently and effectively met by the current regime which has very low operating costs by international standards.

No answer is proffered to this vexed issue in this article, other than that the Act is an uncomfortable middle ground which imposes public obligations on private insurers. First, an overview of the Act is outlined and then the implications for insurers, employers and employees are detailed.

## COVER

The Act provides cover for accidents: work and non-work.

The Act is divided into a number of parts which broadly deal with cover (both work and non-work), dispute resolution, competitive provision of accident insurance and requirements for insurers. There is little notable difference between the previous regime for non-work injuries (which ARCIC will continue to cover) and the new one. Hence this overview will concentrate on work injuries.

Employers are required to obtain insurance cover for employee's work injuries. Each insurer is required to offer an accident insurance contract within ten days of receiving a request for insurance from an employer. The insurance contract must offer the statutory requirements set out in the Act, including weekly compensation of at least 80 per cent of the employee's wage. Insurers must meet the cost of treating an injury, such treatment is to be necessary, timely, appropriate, and of a required quality. Rehabilitation has been made the responsibility of the insurers.

The contents of an insurance contract will closely follow the cover currently available under the 1992 Act. The insurer has very little choice in policy wording and exclusions.

However, the definitions for "work injury" are different to the current legislation. There is likely to be initial litigation over the definitions and also the boundaries between work injuries and non-work injuries.

Each insurance policy will have a number of key terms implied, namely:

- that the insurance policy applies to every employee and every work injury for which the policy provides cover;
- claims must be received and determined in accordance with the Act's procedures;
- minimum statutory entitlements;
- every employee may enforce the policy as if the employee were a party;
- the statutory dispute resolution process applies;
- the policy remains in force until terminated in accordance with the Act;
- an insurer cannot decline a claim for non-disclosure/misrepresentation: however the insurer may recover a specified amount of damages for such non-disclosure. This does not necessarily bear any relationship to the expense incurred.

## PREMIUMS

The insurer must offer an accident insurance contract to each employer or person who requests accident insurance. This is intended to prevent "cherry picking". However, there is currently nothing to stop an insurer setting unrealistic premiums and thus being selective about the risks it wishes to underwrite.

## GENERAL REQUIREMENTS FOR AN INSURER

For an insurer to enter into contracts for insurance it must:

(i) be incorporated in New Zealand;

(ii) have a current rating under the Insurance Companies (Ratings and Inspections) Act 1994;

(iii) have appointed a prudential supervisor;
(iv) have a registered and approved trust deed; and
(v) have a designated reviewer.

## PRUDENTIAL SUPERVISOR

The insurer must have a prudential supervisor, such as a trustee company. A supervisor must monitor the solvency of the insurer and the ability of the insurer to pay the insurer's actual and contingent liabilities. The insurer must enter into a trust deed which provides a mandatory first ranking charge of its assets in favour of the prudential supervisor. This may cause difficulties for an insurer seeking to raise debt capital. It may also have implications for an overseas funder of a New Zealand-based subsidiary insurer.

## INSOLVENT INSURER'S FUND AND NON-COMPLIER'S FUND

There will be an Insolvent Insurer's Fund, partially funded by the Crown and employers. Insurers can also be required to contribute.

There will also be a non-complier's fund, to provide statutory entitlements where, for example, an employer fails to insure. Insurers must contribute to the non-complier's fund. Thus employers are underwriting insurers and insurers are underwriting their competition and employers.

## REGULATIONS

Much of the area will be governed by regulations. The powers to make regulations under the Act are very wide. Examples include setting of the costs an insurer must pay for treatment or rehabilitation.

Most regulation-making powers require consultation with groups the Minister considers appropriate.

## RISK SHARING

The Act permits employers and self-employed persons to risk-share. They can do this by agreeing with an insurer to discharge some of the insurer's obligations under an accident insurance contract (although the parties cannot contract out of the dispute resolution procedures prescribed by the Act).

The Act ensures that the insurer still provides cover, even if a risk-sharing employer does not meet its obligations.

## CLAIMS

Insurers have a statutory duty to make "reasonable" decisions in respect of claims. The breadth of this provision has the potential to open the floodgates to a large volume of litigation. Anecdotal evidence is that the volume of litigation increased tenfold upon the introduction of worker's compensation in New South Wales.

Insurers are split into "receiving", "managing" and "contributing" insurers. A receiving insurer is the insurer who initially accepts the claim, and a managing insurer is the insurer responsible for providing the entitlements under the Act. An employee makes a claim to the insurer they consider appropriate. The receiving insurer can then transfer the claim once the managing insurer has been determined. This distinction has been introduced to deal with gradual process injuries. Such injuries may have multiple causes arising over many years, and potentially be caused by both work and non-work activities. The split of insurers is designed to ensure that cover is available to employees. The current insurer will not be able to simply decline cover because the accident did not occur during the period of insurance.

The insurer must take steps to decide a claim as soon as practicable, within 21 days after receipt of a claim. A failure to decide is deemed to be a decision to accept. The insurer must give notice of its decision to an insured in writing, and if declined, the insurer must provide reasons and notify the insured of the right to a review.

## DISPUTE RESOLUTION

The mode of dispute resolution is prescribed by the Act. The insured may seek a review of the insurer's decision at the cost of the insurer. There are rights of appeal to the District Court. Appeal is available to the High Court and Court of Appeal on questions of law. Insurers are also bound to meet the costs of the Court on a general annual basis.

This requirement constrains the ability of the insurer and the insured to resolve their dispute by other means such as mediation, arbitration or negotiation. Unlike the Employment Contracts Act, there is no provision for the parties to form alternative arrangements that are consistent with the spirit of the Act.

## EMPLOYER IMPLICATIONS

Each employer must enter into an accident insurance contract. Failure to insure can attract either a civil or criminal sanction.

All employees must be covered by the same accident insurance contract, regardless of the type of work they do. This may make it difficult for some employers to "shop around" to get the best premiums. The supporters of the Act state that it provides incentives for employers to invest in health and safety, as their premiums will reflect decisions they make in this area. However, premiums are likely to be set on an industry-wide basis, due to the cost of assessing each employer.

An employer must provide employees with a written statement detailing the accident insurance contract. An accident insurance contract cannot be terminated until a new one is in place, or the employer is liable for a fine of up to $50,000. Employers must also contribute to the Insolvent Insurers fund. Many employers are bitterly opposed to this, yet the Government claims it will provide an incentive to choose a prudent accident insurer and monitor its ongoing solvency.

Employers can also expect an increase in premiums to cover increased transaction and regulatory costs. Overseas experience shows premiums are likely to be volatile.

## SELF-EMPLOYED

The self-employed can choose to take out an accident insurance contract, or continue to be covered by the ACC. The premiums collected by ACC go to a separate Self-Employed Work Account. ACC will also deduct an extra premium from the self-employed who choose to remain with ACC, to ensure "competitive neutrality with other insurers".

## IMPLICATIONS FOR EMPLOYEES

Many of the steps outlined above have been introduced to ensure employees always have cover. Employees will become the beneficiaries of an accident insurance contract to which they are not a party. Employees will have no input into the

*continued on p 52*

# DIRECTORS' LIABILITY IN TORT

*Andrew Borrowdale, The University of Canterbury*

*explains the limits of directors' liabilities*

In *Salomon v Salomon & Co Ltd* [1897] AC 22 (HL) it required an appeal to the House of Lords to redress the decisions of the Courts below and establish the fundamental principle of separate corporate personality upon which modern company law rests. One hundred years later the decision of the House of Lords in *Williams v Natural Life Health Foods Ltd and Mistlin* [1998] 1 WLR 830 similarly overturned the Courts below. Just as *Salomon* crystallised a disarmingly simple proposition, so too does *Williams*, holding that a director who gives negligent advice in the course of company business is not without more liable to the recipient of that advice. Just as *Salomon* divided commentators of the time, so too has *Williams*.

## WILLIAMS v NATURAL LIFE

First, the facts. Mistlin was the principal shareholder and managing director of Natural Life Health Foods Ltd. His wife was a nominal shareholder and employee of the company. There were two other employees. The company traded by selling franchises for health food shops. Williams and his business partner purchased a franchise for a health food shop in Rugby. They were encouraged to do so by promotional material and financial projections provided by an employee of the company, who was not Mistlin. The business closed after 18 months of trading at a loss. Williams sued the company for negligent advice. Mistlin was joined as a defendant when in 1992 the company was liquidated and later dissolved. The trial Judge and a majority in the Court of Appeal held that Mistlin was personally liable for the company's negligent misstatements to Williams and his partner. (For commentary on the decisions of the trial Judge and of the Court of Appeal see Borrowdale "Director's liability for corporate misstatements" [1997] NZBLQ 211.) He was said to have assumed personal responsibility for the company's negligent misstatement. The House of Lords held he had not.

The judgments in *Williams* at all levels draw upon the principles expounded by the New Zealand Court of Appeal in *Trevor Ivory Ltd v Anderson* [1992] 2 NZLR 517. There, the director of a company giving farming advice negligently advised the use of a spray which caused the destruction of the plaintiffs' berry crop. It was held unanimously that the director was not liable to the plaintiffs. *Trevor Ivory* has been furiously resisted by various commentators. (See, for example, Wishart (1992) 10 C&SLJ 363, [1993] NZLJ 175; Fridman "Personal tort liability of company directors" (1992) 5 Cant L Rev 41. For a defence of *Trevor Ivory* see Borrowdale "Liability of directors in tort – developments in New Zealand" [1998] JBL 96.) In New Zealand it has largely fallen to Professor Stephen Todd to make the arguments in favour of director liability, and predictably Professor Todd criticises the decision in *Williams* as well in his 1998 New Zealand Law Society Seminar paper *Update on Torts*.

## WHY LIABILITY?

The essence of the argument by proponents of director liability is this. Let us assume that the conduct of the individual director outside the context of the company would ordinarily entail personal liability for advice negligently given. In *Trevor Ivory*, for example, the individual would undoubtedly have been liable had he been trading as a sole trader, and not through the vehicle of the company. Why then, it is asked, should personal liability for the director of a company not follow for the very same conduct?

Superficially, this argument is beguiling where the conduct in question is negligent advice. The classic *Hedley Byrne* formulation seems to fit: a person (the director) possessed of a special skill undertakes to apply that skill for the benefit of another person (the plaintiffs in *Trevor Ivory*, and in *Williams*) who relies upon such skill: *Hedley Byrne & Co Ltd v Heller & Partners Ltd* [1964] AC 465 (HL) at 502, per Lord Morris. In non-*Hedley Byrne* cases a Court may be more flexible, because there looms large the policy consideration of whether the doctrine of separate corporate personality should be eroded. In those cases the determinant of liability is really whether an individual director has by his or her conduct so intruded himself or herself as to forgo the protection of the *Salomon* doctrine. In the *Hedley Byrne* situation, on the other hand, the Courts have said that "once the case is identified as falling within the *Hedley Byrne* principle, there should be no need to embark upon any further inquiry whether it is 'fair, just and reasonable' to impose liability for economic loss": *Henderson v Merrett Syndicates Ltd* [1995] 2 AC 145 (HL) at 181, per Lord Goff.

In *Williams* the approach taken by the House of Lords was to refine the test of assumption of responsibility. The phrase "assumption of responsibility" has a variety of meanings, but for present purposes two are relevant. It means firstly assumption of responsibility for *performance* of the task in hand. Where the company is in contract with the plaintiff, and the subject of the contract is the provision of the very advice or service that has caused the plaintiff's loss, then it is self-evident that it is the company which has assumed responsibility for performance. If we focus upon where liability for actually undertaking the task in hand lies, it is obvious that it lies with the contracting party, the company. It is absurd and unnecessary to argue that with regard to the plaintiff it lies with the company's agent. In this sense assumption of responsibility is simply evidence of a contract to perform.

But that is not the sense in which it is used in cases such as *Williams*. Here it means assumption of responsibility for the liability flowing from a negligently performed service or from negligent advice. In the above scenario, where the company is liable for performance, and therefore necessarily for liability for deficient performance, it is hard to imagine why the actor should undertake responsibility for liability as well. Essentially the company has subcontracted performance to its agent. The agent may well be liable to the company for deficient performance, but responsibility to the plaintiff for performance and responsibility for deficient performance is always the company's. Even on a strict *Hedley Byrne* formulation, the agent does not undertake to the plaintiff to exercise a skill upon which the plaintiff relies. In the case of a contractual relationship between company and plaintiff, then, one can confidently say that an agent is never liable to the plaintiff unless there is some indication that the agent independently guarantees his or her performance.

The context in which the decision in *Hedley Byrne* was given was the absence of any contractual obligation or undertaking to provide the information in question. That does not matter, said the House of Lords, because a person who gratuitously, and not under an obligation imposed by contract, assumes responsibility for giving advice, should be liable if bad advice is negligently given to a person who relies upon it and who suffers loss as a result. Now it is immediately apparent that the rule in *Hedley Byrne* could never have been intended to extend to the situation in *Trevor Ivory*. In essence, *Hedley Byrne* saves the recipient of negligent advice who cannot rely upon a contract. In *Trevor Ivory* the plaintiffs did have a contract with the defendant company, and it is presumably for this reason that Cooke P dismissed *Hedley Byrne* as being simply not applicable to the facts of that case.

Todd argues that assumption of responsibility in the *Hedley Byrne* context, should mean (and until *Williams* has always meant) no more than choosing to speak or act. (*Update*, p 18) Perhaps, but why then did Lord Devlin in *Hedley Byrne* itself refer to the assumption of "a *legal* responsibility"? At 532, emphasis added. Even if Todd is correct that *Williams* marks a departure, it is difficult to understand why this is per se a wrong turning in the law. The words of the Law Lords in *Hedley Byrne* are not written in stone. The issue in *Williams*, should the individual corporate actor be liable in addition to the company, was not an issue in *Hedley Byrne*.

## CONCLUSION

Is there a difference in temperament between tort and company lawyers which ensures that they will always be divided over cases such as *Trevor Ivory* and *Williams* where principles of tort and company law intersect? The tort lawyer always begins with the act of the individual actor; if he or she is also the agent or employee of a company, then the tort lawyers lifts his or her gaze to contemplate the company as an additional defendant. This is foreign to the company lawyer, who always begins with the company, and extends his or her inquiry to the individual only if there is evidence that the corporate form has been disregarded.

Hopefully in time one can coax opponents of *Trevor Ivory* and *Williams* towards recognising that in New Zealand at least, the dichotomy between the heads of liability represented by *Donoghue v Stevenson* and *Hedley Byrne* respectively is weak. A New Zealand Court is not averse to a soupcon of policy, justice, fairness even in a *Hedley Byrne* type case such as *Williams*. An excellent example is *Jagwar Holdings Ltd v Julian* (1992) 6 NZCLC 68,040 where these considerations were emphasised in an action against director defendants (who would have been found liable in negligence had they not been liable for deceit). Accordingly in New Zealand there is no doctrinal or other Levitical obstacle to refinement of the test of assumption of responsibility as has occurred in *Williams*. ❑

***continued from p 50***

choice of insurance companyor the provision of any extra cover in addition to statutory entitlements. It may become the employee's responsibility to pay for treatment and then seek back payment from the insurer.

Employees must submit claims within 12 months of the accident and provide all information "reasonably" required by the insurer. The Act provides that if an insurer fails to decide a claim within 21 days, the claim is deemed to be accepted. Employees can apply for a review of an insurer's decision, with costs carried by the insurer.

## CONCLUSION

The Accident Insurance Act is a step towards full privatisation of accident compensation. It attempts to bridge the crevasse between the current scheme and the market paradigm. This attempt to satisfy two quite different ideologies simultaneously leads to obvious conflicts in the policy objectives and principles embodied in the Act.

From an insurer's perspective the Act compromises many key elements of insurance law. Generally, insurers control their risk by defining the scope of cover, resolving claims and exercising rights of subrogation. Under the Act cover and entitlements are defined and compulsory. If an employer or employee fails to declare an important fact or makes a material misstatement, the insurer cannot cancel the policy or decline the claim. The insurer is restricted to imposing financial penalties on the employer. There are very limited rights of subrogation, so an insurer cannot allocate costs and risk to the party who caused the injury. The dispute resolution provisions are mandatory. Thus the traditional means of allocation of cost and risk are missing from the legislation.

In summary, the philosophy and principles behind accident compensation are markedly different from the philosophy and principles that drive the insurance industry. The Law Commission report (1988) stated emphatically that the ACC scheme was "*not in any sense an insurance system: benefits are provided as of right without reference to cause and regardless of risk*" (*Personal Injury: Prevention and Recovery* Law Commission Report 4 (Wellington 1988), noted in 21 TCL 36). The reforms may well highlight the difficulty of superimposing insurance principles on a social welfare scheme. ❑

# LEASE INDUCEMENTS

*Andrew Maples, The University of Canterbury*

*explores the "insoluble conundrum" of the capital income distinction*

> No part of our law of taxation presents such almost insolvable conundrums as the decision whether a receipt or outgoing is capital or income for tax purposes.
>
> Lord Upjohn in *Regent Oil Co Ltd v Strick* [1966] AC 295,343.

On October 29, 1998 the Privy Council delivered its long awaited decision on the tax treatment of a $5 million lease inducement paid to international accountancy firm, Coopers & Lybrand (C&L), now part of Price Waterhouse Coopers (*CIR v Wattie* (1998) 18 NZTC 13,991) The decision is significant because of the large sum involved and because it clarifies the tax treatment of such cash lease incentives. It is, however, of even greater significance as it represents a restatement of the boundary between capital and revenue gains from the ultimate Court for New Zealand taxpayers.

Prior to any case law on the issue, but based on well established tax principles, a lump sum payment to induce a tenant to enter a lease would arguably be considered a capital receipt in the hands of the recipient. This view is supported by a number of cases including, in New Zealand, the Court of Appeal decision of *CIR v McKenzies (NZ) Ltd* (1988) 10 NZTC 5,233. That case decided that a payment made by the tenant to secure the termination of a long and onerous lease was on capital account and not deductible.

This "accepted view" was challenged by the Australian Federal Court decision of *FCT v Cooling* 90 ATC 4472. The Court held that the $162,000 lump sum cash incentive payment to partners of a law firm to enter a lease was assessable. This was on the basis that the receipt was derived in the ordinary course of the taxpayers' business. The decision was one of a number of Australian decisions at the time which widened the concept of business income under ordinary principles, with the result that it blurred the capital-revenue distinction. This trend had begun with the Australian High Court decision *FCT v The Myer Emporium Ltd* 87 ATC 4363. As a result, the decision of the Privy Council would be of great importance – in particular, would Their Lordships follow traditional principles to distinguishing between capital and revenue receipts or endorse some other approach?

## THE FACTS

As a result of a depressed economy, there were high vacancy rates in the Auckland central business district in 1991. Owners and developers of buildings were anxious to secure major tenants for their developments and were therefore prepared to negotiate substantial deals to attract key tenants.

At this time C&L decided to move into new premises. After negotiations, they entered into a 12 year non-assignable lease of a 29-storey office block in Auckland. They signed a collateral deed at the same time. The collateral deed provided C&L with a number of incentives totalling $15.08 million. Based on the agreement to lease the rent for the premises for the first six years was $349.83 per square metre. The true rent, however, when the various incentives were taken into account was $18.97 per square metre.

The incentives included a monthly rent subsidy of $94,008 and a one off $5 million lump sum inducement payment. C&L treated the rent subsidy as assessable income and the inducement payment as a capital receipt. The Commissioner of Inland Revenue ("CIR") argued that the incentive was on revenue account. In his view it was essentially a form of rent subsidy or, alternatively, it was derived in the course of the current operations of C&L's business.

## HIGH COURT AND COURT OF APPEAL

Fisher J found in favour of the CIR. He held that the inducement payment was a type of rent subsidy and therefore assessable. In so finding he focused on the substance of the transaction rather than its form. C&L appealed the decision.

The majority of the Court of Appeal (Richardson P, Gault, Henry and Blanchard JJ, (Thomas J dissenting)) overturned the High Court decision.

The majority found that the payment was not a rent subsidy for three reasons. Firstly, there was evidence that a substantial incentive was necessary for C&L to forgo its freedom to enter a lease elsewhere and to accept the burden of a non-assignable lease. Secondly, while it was possible in economic terms to view the inducement as a rent subsidy, economic equivalence is not the determining factor in characterising a payment for tax purposes. Rather, in tax cases, provided the transaction does not involve tax evasion or is not a sham, its tax treatment is determined by the commercial effect produced and not the substance of the transaction. Finally, signing up tenants of the calibre of C&L was a great and significant benefit to the lessor.

The majority of the Court of Appeal applied *McKenzies* to the facts before them. C&L were paid $5 m by the lessor for undertaking an onerous lease for a substantial period. The payment was a "negative premium" and therefore "the mirror image" of the termination payment in *McKenzies* case.

The Court of Appeal rejected the CIR's other arguments based on the application of *Cooling* and *Myer*.

Thomas J was of the same view as Fisher J in the High Court.

The CIR appealed the decision to the Privy Council.

## PRIVY COUNCIL

In an emphatic 16 page judgment delivered by Lord Nolan, the Privy Council rejected the CIR's appeal.

### The submissions

The CIR argued that the inducement –

(i) represented a rent subsidy, and therefore was also assessable as business income; or

(ii) was, in the alternative, assessable as a gain arising from a venture entered into in part for the purpose of making a profit.

C&L submitted that the inducement was of the same nature as a lease premium except in this case paid by the landlord rather than the tenant and, therefore, a capital receipt.

The parties accepted that the inducement was not a receipt arising from the ordinary business operations of C&L. Neither could it be regarded as arising from an ordinary incident of their business. This was an acknowledgment by the CIR that the principle in *Cooling* should not be applied in New Zealand. Both the High Court and Court of Appeal had also chosen not to follow *Cooling*.

### The Privy Council's conclusion

*Rent subsidy or negative premium?*

The Privy Council followed the traditional approach to characterising the nature of a receipt. Whether a receipt is on capital or revenue account:

> depends on what the expenditure is calculated to effect from a practical and business point of view, rather than upon the juristic classification of the legal rights, if any, secured, employed or exhausted in the process. (per Dixon J in *Hallstroms Proprietary Ltd v FCT* (1946) 72 CLR 634, 648)

What the inducement was calculated to effect from a practical and business point of view was to be determined from the particular facts of the case. In an attempt to have the Privy Council look beyond the form of the transaction to its economic substance, the CIR submitted that such an inquiry inevitably "... involved a review of the factual context in which the payment was made".

In response to this, Their Lordships believed the reasoning of Lord Wilberforce in *Regent Oil Co Ltd v Strick* [1966] AC 295 was applicable: the Courts will look at the nature of the payments, ie lump sum, the nature of the advantages obtained and the period involved.

C&L accepted that the inducement was linked "commercially, financially and mathematically" to the lease payments made by them. This, they submitted, would "normally be true of the ordinary premium payable by a lessee to a lessor upon the grant of a lease". Their Lordships noted that in both New Zealand and the United Kingdom, where there is no specific legislation dealing with the matter, such a premium has always been viewed by the Courts as a capital rather than a revenue receipt. This is on the basis that such payments are made –

> not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade ... (Viscount Cave LC in *British Insulated and Helsby Cables Ltd v Atherton* [1926] AC 205, 213)

The crucial issue in the current case was –

> whether in all the circumstances, the payment or receipt can properly be attributed to a particular year. The question is crucial because income tax is charged annually upon the income or profits of each year. If the payment or receipt cannot properly be brought into the income tax reckoning for a particular year, then (apart from special statutory provision) it cannot be brought into that reckoning at all.

Applying these principles the Court of Appeal in both *McKenzies* and in *Wattie* held that the relevant payments were on capital account. Their Lordships agreed with the majority view of the Court of Appeal in *Wattie*.

*A profit seeking purpose?*

While accepting that C&L's dominant purpose in entering the transaction was to acquire new office space, the CIR contended that there was also a purpose of securing a profit of $5m. The majority of the Court of Appeal rejected this submission. The Privy Council concurred with their finding. In Their Lordship's view the inducement could only be regarded as a profit "if it constituted a benefit or bonus accruing to Coopers & Lybrand quite independently of the other terms of the bargain between the parties".

This would be an erroneous view. Rather, in Their Lordships' opinions, on the basis of the evidence as "the undertaking was equal in value to the price then there could be no profit element in the latter".

## WHAT DOES IT ALL MEAN?

The Privy Council, in a succinct judgment, has reaffirmed the traditional approach to distinguishing between receipts of a capital and revenue nature. The fact that the decision is relatively short and that Their Lordships were unanimous is a clear signal that other approaches to determining capital-revenue issues are unwelcome and unwarranted. This perhaps will be the most significant implication of the decision, especially as it seems likely that in the future, legislation will be enacted to tax lump sum lease incentives.

The decision has confirmed the limitations of the application of *Myer* and *Cooling* in New Zealand.

In a number of Canadian decisions, the Canadian Courts appear to have adopted a different approach from that of New Zealand and the United Kingdom. This was noted in the Privy Council judgment. On the basis of the *Wattie* decision, arguably the Canadian cases on this point will no longer be persuasive authority in New Zealand.

As already mentioned except in cases involving sham transactions or tax evasion, the Courts historically have not looked beyond the form of a transaction to its economic substance. There has been a growing recognition, however, that in other cases it may also be appropriate to tax on the basis of economic equivalence. This approach has now clearly been rejected by Their Lordships. The decision makes it clear that the CIR must follow the form of legal documents only.

In *The National Business Review* ("Managers deny cash payments", November 13, 1998, p 58) the Director of Litigation for the Inland Revenue Department, Mr Mike Lennard, is reported as saying there were about 200 cases

***continued on p 56***

# UNPERFECTED SECURITIES UNDER THE PPSA

*Professor D W McLauchlan, Victoria University of Wellington*

*responds to D F Dugdale's article on the proposed PPSA*

In the November 1998 issue of this journal at [1998] NZLJ 383, Mr Dugdale argued that unperfected securities should prevail over unsecured creditors. He argued that there is no logical basis for avoiding unperfected security interests in personal property against assignees in bankruptcy, liquidators or execution creditors under the proposed PPSA. Since then the long awaited Personal Property Securities Bill has been introduced to Parliament. That Bill contains a curious compromise. While execution creditors have priority over unperfected securities, assignees in bankruptcy and liquidators do not.

Mr Dugdale's position is one with which I strongly disagree. He will not be surprised to learn this. We crossed swords on the issue in the course of the 1988-89 deliberations of the Law Commission's advisory committee and at last August's Legal Research Foundation symposium. His main point is a relatively simple one. Protection of unsecured creditors against unperfected securities should not be included in the PPSA because the policy against "secret liens" which underlay such protection in the past is outdated. Whatever may have been the position when the first Bills of Sale Act (UK) was enacted in 1854, unsecured creditors no longer make their decisions to grant credit on the basis that debtors own the goods in their possession. There is little danger of "false credit" being granted nowadays on the basis of a debtor's appearance of being in good circumstances. This explains the decision not to re-enact the reputed ownership clause of the Bankruptcy legislation in the Insolvency Act 1967 as well as the absence of an equivalent of s 18 of the Chattels Transfer Act 1924 in the Motor Vehicle Securities Act 1989.

I do not disagree with Mr Dugdale that the policy he describes, on which protection for unsecured creditors was previously based, no longer applies. I am prepared to accept that unsecured creditors do not assume that assets in the possession of their prospective debtors are owned by them. However, in my view, it does not follow that there is no basis for including protection for unsecured creditors in the proposed PPSA.

It is worth observing at the outset that all of the North American models on which our PPSA is based subordinate unperfected security interests to trustees in bankruptcy, liquidators and execution creditors. So far as I am aware this protection for unsecured creditors has not been seriously challenged. My point here is that we ought to be slow in New Zealand to exclude such protection and enact a statute which is already heavily biased in favour of the interests of secured creditors. We ought to be satisfied that the reasons for the protection are not applicable here. And, in this context, one point is clear. The North American policy is not that identified and criticised by Mr Dugdale. As Professor Ron Cuming, the leading Canadian expert on PPSA systems, pointed out in a letter to the Law Commission in 1989 commenting on the draft Bill: "No one believes that unsecured credit is granted on the strength of apparent ownership resulting from possession of assets. Accordingly, deception is not the issue".

In any event, Mr Dugdale understates the argument based on deception. The reason unsecured creditors do not, indeed cannot, rely on possession of assets as indicative of ownership is not simply the widespread use of hire purchase and other retention of title devices. There is the further element that, except where motor vehicles are involved, such devices are not subject to registration requirements. However, all that will change in the new PPSA environment. The Act will provide for perfection by registration of all non-possessory security interests in personal property, regardless of their form. Accordingly, unsecured creditors might well search the register and feel reasonably entitled to draw conclusions from the information gained as to the financial status of the debtor. There clearly is potential for deception where a search fails to reveal the existence of attached security interests.

Interestingly, it was the latter argument, not the one articulated by Mr Dugdale, that was rejected by a majority of the Law Commission's advisory committee. It was their view (see *A Personal Property Securities Act for New Zealand* (1989) NZLC R8, p 115) that "[c]reditors who supply goods or funds on an unsecured basis are generally either not concerned about the presence of outstanding interests, or assume that such interests exist". I am prepared to concede that most unsecured creditors will not conduct searches because they are unconcerned about the value of their debtors' assets. But this will not invariably be the case. Consider, for example, the large amount of unsecured lending that is currently undertaken in New Zealand on an unsecured basis pursuant to negative pledge arrangements. I imagine that once the new regime is up and running such lenders will routinely search the register before making further advances to check whether their debtors are honouring their obligations.

However, the case for subordinating unperfected securities to the claims of unsecured creditors does not hinge solely, or indeed principally, on one's view of the likelihood of deception. There is a more compelling policy argument.

The law confers tremendous advantages on secured creditors which will be substantially enhanced once PPSA is enacted. Whether such advantages can be justified on economic and social policy grounds is a matter that has been the subject of voluminous literature of late, particularly from North American law and economics scholars (see, for example the *Symposium on The Priority of Secured Debt* in (1997) Cornell L Rev 1279-1567). And no doubt the various arguments for and against providing increased protection for unsecured creditors against even perfected securities, such as conferring partial priority or setting aside a portion of the debtor's collateral for them, will be hotly debated by those currently charged in New Zealand with responsibility for insolvency law reform. Against this background, it is more than a little surprising that the legislature should be contemplating enactment of an elaborate scheme governing the attachment and perfection of security interests which says to a secured creditor, in effect: "Although the main reason you take a security interest is to guard against the debtor's insolvency, actually it doesn't matter that you have not taken the elementary steps we have prescribed to perfect your security. You are entitled to priority anyway in the event of insolvency over unsecured creditors". One is even tempted to ask in these circumstances: is the proposed registration system really necessary just to regulate priority disputes between secured creditors, or between secured creditors and subsequent purchasers? Perhaps all that is necessary so far as the latter kind of dispute is concerned is refinement of the current regime in the Motor Vehicle Securities Act 1989, for it is undeniable that the vast majority of such disputes involve motor vehicles. However, the main point I wish to make is a more simple one. Secured creditors who have not abided by the rules of the game by perfecting their security interests should be disqualified. Surely this is a bare minimum step that the law should take in redressing the balance somewhat in favour of unsecured creditors?

Of course it is true that the protection I advocate for unsecured creditors may in practice be to a large extent cosmetic. It will be a relatively rare case where, under the simple and cheap procedures proposed for PPSA, a secured creditor fails to file (or files in a manner that is seriously misleading). But, to my mind, the message is worth sending: abide by the rules or you will be relegated to the pool of unsecured creditors. Indeed, I would find it surprising if there were many involved in the secured credit industry who objected to this message. Further, some might be shrewd enough to actively support it as being in the long-term interests of the industry. For the concession is a relatively minor one and, bearing in mind the heavy bias of the legislation in favour of secured creditors, it may operate as a pre-emptive move against reforms of insolvency law which take away some of the advantages gained.

There are other, perhaps more practical reasons, for supporting the protection I advocate. For example, it is one means of encouraging compliance with the Act and ensuring the integrity of the register. More importantly, it is undesirable that creditors should be able to "pull secret securities out of the hat" after the commencement of insolvency. Some have even argued (see *LawTalk*, 512, 1 February 1999, 16) that failing to avoid unregistered interests would give rise to the danger of security agreements being fabricated or backdated. I myself would not give too much weight to this, but it is highly likely that, if the Bill is enacted in its present form, liquidators and assignees in bankruptcy will sometimes face considerable time and expense investigating the validity of secured creditors' claims. Would it not be better to have a blanket rule: if a security interest is not perfected, priority is lost?

It must be noted finally that, even if my arguments are not accepted, the position of execution creditors raises separate considerations. Under the policy favoured by Mr Dugdale, creditors levying execution on assets which are subject to attached but unperfected security interests will potentially be liable not only to refund the proceeds of the execution, but also to pay damages for any difference between those proceeds and the actual value of assets seized, or even for consequential losses. No doubt considerations such as these prompted the inclusion in the Personal Property Securities Bill of cl 102 which subordinates unperfected securities to execution creditors. However, this provision in turn gives rise to anomalies. For example, why should creditors who manage to complete execution just prior to the commencement of insolvency enjoy priority over unperfected securities but not those whose execution is incomplete, or indeed unsecured creditors generally? The Bill, as currently drafted, might even have the effect of encouraging the holder of an unperfected security to put its debtor into bankruptcy or liquidation at the first sign of trouble, with the worst scenario being a messy circular priority problem (ie execution creditor priority over secured creditor, secured creditor priority over assignee in bankruptcy, but assignee in bankruptcy (through relation back) priority over execution creditor). ❑

***continued from p 54***

that would have been prosecuted had the Privy Council ruled in the CIR's favour. Now, however, the "majority of those cases would probably ... be abandoned". It will be interesting to see whether this is the case or whether the CIR takes a narrow view of the decision and attempts to distinguish it from other cases before him where there are different forms of contracts and documentation in place.

*The Independent* ("Gov't to trump Privy Council", 11 November, 1998, p 3) reports that: "Lease inducements are becoming prevalent again in the depressed property market, particularly from developers chasing tenant precommitment to get bank funding".

According to that article such incentives are, however, now more in the nature of free fit-outs or rent holidays. This may change with the *Wattie* decision and must be of concern to the IRD. Indeed in that same article, Mr Robin Oliver, IRD General Manager Policy Advice is quoted as saying: "In the light of the ruling we have to look at how much of the tax base could be exposed. We're concerned people could take normal income and turn it into lease inducements".

Finally, in the 1998 Budget the government identified the tax treatment of lease incentives as a fiscal risk to the revenue and indicated that such receipts should be taxable. Now that the decision has been delivered in the taxpayer's favour, some legislative action making lease inducements taxable in the near future is likely. The *National Business Review* ("*Lease inducements face tax*", November 13, 1998, p 1) notes that both the National-led government and Labour opposition are committed to taxing cash incentives. Only time will tell what measures are taken and whether they will extend to other forms of lease inducement. Consequently the taxpayer's collective victory may only be short lived. ❑

# CASE MANAGEMENT SANCTIONS

LITIGATION

*with*

*Andrew Beck*

Case management procedures are all very well until it comes to policing the unruly. The sanctions attached to the procedures are not generally given much attention, and it is of some interest to note that the Auckland and Napier Case Management Practice Note contains very little reference to the consequences of non-compliance. Reliance is placed on the Court's powers under R 277 of the High Court Rules and the discretion to make appropriate costs orders.

In its terms, R 277 provides for several Draconian remedies, including committal, sequestration, dismissal of the proceeding and striking out of the defence. Yet in the twelve years that the High Court Rules have been in operation, only a handful of decisions have ever gone further than making an adverse costs award against a defaulting party. It is undoubtedly true, as observed in *McGechan on Procedure*, that the approach of the Courts has traditionally been a benevolent one.

## THE TRADITIONAL APPROACH

The difficulty is, of course, that there are two fundamentally conflicting principles at stake. On the one hand there is the public interest in ensuring expeditious justice and respect for orders made by the Courts; on the other is the reluctance to deprive a party of the right to litigate the merits of its case because of its failure to meet procedural requirements. This conflict was well expressed by Young J in *Lees Trading Co (NZ) Ltd v Loveday* 3 June 1998, HC Christchurch CP 70/96, where he said (at 11):

> There is a problem matching the general demands of case management (necessary if litigation is to be resolved efficiently and judicial resources and Court infrastructure is to be made proper use of) with the provision of individual justice in each case, particularly given the aversion Judges have to dismissing claims otherwise than on their merits. For better or worse, the compromises the Courts have made are weighted very much in favour of the second of these two considerations.

In that case, after a considerable period of inactivity, the plaintiff had been ordered to provide a verified list of documents within 28 days. At the time of making the order, the Master noted that, should it not be complied with, he anticipated a striking out application under R 277. The order was not complied with, and an application was made accordingly. No affidavit or notice of opposition was filed, but at the subsequent call of the case, the Master granted leave to appear, but refused to allow evidence from the Bar. As the Master considered that there had been wilful default, he granted the striking out application.

The defendant applied to review the Master's decision, and was granted leave to file affidavits retrospectively. The list of documents was then filed. From the affidavits, it appeared that there had been funding difficulties preventing completion of the discovery, and that there had been some communications between the solicitors in this regard.

On review, Young J considered that the fundamental problems were a lack of funding, an unwillingness by those controlling the plaintiff to commit themselves to the litigation, and a lack of drive by counsel for the plaintiff. He accepted that there had been a failure to take what, in hindsight, would have been the obvious steps.

Young J followed the traditional approach referred to in *McGechan*, that belated compliance will only be punished by striking out where there has been either wilful default or serious prejudice. He considered that wilful default requires "contumacious or contumelious conduct", and therefore requires more than mere knowing about an order and not complying with it. As these epithets could not be applied in the situation, striking out was an inappropriate remedy. The Court did, however, award costs of $4,500 with an order that it be paid within six weeks.

The same approach was adopted by Young J in a more recent decision, *Prokofyev v Karelrybflot* 12 Oct 1998, HC Christchurch AD90/98. The plaintiffs had failed to comply with timetable orders to provide particulars and Briefs of evidence. A fixture on 27 July had to be abandoned, and at the subsequent fixture on 12 October 1998, the defendants applied for an order striking out the proceeding.

Young J justified his adherence to the conventional approach:

> For my part I continue to think that Judges should regard the procedures of the Court as a means to an end and not as an end in itself.

He accepted that, at the minimum there should have been an affidavit to explain the delay. Having heard an explanation from the Bar, he was not satisfied that there had been a serious or effective attempt to prepare briefs in time. Although he regarded the case as closer to the line than *Lees*, he was not prepared to consider it any more than a "muddle and bad management" which did not amount to wilful default.

There would, however, be serious prejudice to the defendants if the trial were to proceed, because they would be unable to prepare a response to certain matters. Although the Court considered prohibiting the plaintiffs from raising these matters, in the end it considered that would be unfair because they also related to counterclaims against the plaintiffs.

In the end the Court proceeded with the hearing on the understanding that the defendant would be entitled to call further evidence on the matters in question. The plaintiffs' solicitor was ordered to pay personally all costs occasioned by non-compliance with the timetable for briefs because there had been a

> quite extraordinary series of breaches of Court orders and a significant impact on the orderly resolution of these proceedings.

Although quantum was reserved, the Court indicated that it would be fixed on a "generous basis".

## CHANGING ATTITUDES

In *Prokofyev*, Young J avowedly followed the "conventional approach". He referred to indications that a "tougher stance" was being taken by some Judges, but considered that his approach was within "the mainstream of judicial reactions", as well as being the appropriate response. He was fortified in his view by the decision of Fisher J in *Kamo Sports & Dive Ltd v Harrison Sports (Kamo) Ltd* (1993) 7 PRNZ 321.

In *Kamo Sports & Dive* there was a serious failure to provide briefs of evidence in accordance with the agreed timetable. The Court found that there was no excuse for this, and that it resulted in major problems for the conduct of the trial. Fisher J considered the case to be a bad one of its kind, and made an order that the solicitors contribute personally to the costs occasioned by the non-compliance.

What has to be borne in mind, however, is that Fisher J's comment were made at a time when case management was in its infancy in New Zealand, and well before provision for the exchange of briefs was incorporated into the High Court Rules. He noted the pervasive failure to comply with pre-trial directions, and said (at 323):

> At least until now, the Courts have generally reprimanded those involved but taken the view that the most important thing is to get to the merits of the case. If we can possibly avoid it, we do not like to see cases resolved on some procedural or technical basis, no matter how undeserving a party may be from a procedural viewpoint. It would be foolhardy for defaulting parties to think that they will always be able to scrape through on that basis but I will not depart from it today.

There is clearly a foreshadowing of a new approach by the Courts, and an unwillingness to accept a lackadaisical attitude to procedural orders. It is certainly not an indication that non-compliance will only be punished by a costs award.

***There is clearly a foreshadowing of a new approach by the Courts, and an unwillingness to accept a lackadaisical attitude to procedural orders***

The real changes in judicial attitudes probably date from the time of the introduction of the case management pilot in the Auckland and Napier High Courts. The integrity of that system was stressed by Tompkins J in *Samoa Insurance Co Ltd v Boston Marks Group Ltd* (1996) 9 PRNZ 405, where the Court refused to receive affidavits which were filed substantially out of time without explanation. The Court said that the system requires proper compliance with timetable orders save in exceptional circumstances (at 407). Tompkins J reiterated this approach in *New Zealand Vehicle Finance Ltd v Suckling* (1996) 9 PRNZ 597.

A much more vigorous attitude has been expressed by Giles J in *Broadway Motor Inn Ltd v Manor Inns Group Ltd* 10 July 1997, HC Auckland CP 101/96 and *Butler v Li* (1997) 12 PRNZ 23. In the latter case there had been repeated failures to appear at conferences and to make proper discovery, and the Master dismissed the plaintiff's claim. In an application for review, the Court, having received an explanation from the plaintiff and essentially with the concurrence of the defendant, allowed the plaintiff a second chance. This was conditional on payment of costs of $7,750, with a clear direction that responsibility for the costs lay with the plaintiff's solicitors.

Giles J made his view clear that a firm line should be taken with regard to procedural compliance, in order to avoid unnecessary interlocutory applications. He continued to say, however, that R 277 is designed to deal with a "deliberate default". What is meant by that is not entirely clear, because he proceeded to say (at 25):

> Where a party is unable, for good and proper reason, to comply with a Court ordered timetable, then professional courtesy requires that opposing counsel be informed as to the reasons and that a formal application supported by affidavit evidence be put before the Court seeking an indulgence. Where an indulgence is made out, it will no doubt be accommodated, albeit accompanied by a realistic, not nominal, order for costs.

It might be added that this is not solely a matter of professional courtesy; it is a question of non-compliance with a rule or a Court order, which requires a dispensation. The Courts do appear to adopting a more realistic approach to costs in such situations, as illustrated in *Hamilton v Papakura District Council* (1997) 11 PRNZ 43, where $6,000 in wasted costs was awarded where an adjournment was needed in order for the plaintiffs to brief a new expert.

In *Hopman v Peka* 24 April 1998, HC Auckland CP 132/94, Cartwright J was confronted with a situation where the defendant had repeatedly failed to make proper discovery and provide inspection of documents. The plaintiffs applied for the defences to be struck out.

The Court began from the proposition that there is a reluctance to strike out defences except on their merits, but noted that:

> there will be occasions when that step is justified where there is clear evidence of excessive and unreasonable delay in complying with requests and orders for discovery and inspection.

Cartwright J considered the possibility of a costs order, but decided that such an order was unlikely to achieve proper discovery, and also expressed a concern that the costs order might never be complied with. She decided that the defences ought to be struck out, and made the following observations (at 14):

> There are good reasons for requiring greater discipline in complying with orders for discovery and inspection from parties and counsel. First it is important to emphasise that orders

> of the Court should not lightly be ignored. Secondly, the cost to the parties of obtaining discovery when it is resisted can become overwhelming and a disincentive to continuing to seek legitimate resolution of disputes. Passive resistance by defaulting parties should not result in advantage for them. Then it is in the interests of all litigants that full discovery of relevant material pre-trial be available thereby limiting the issues to be determined at trial, and keeping the cost of litigation to a minimum.

Although this is expressed in terms relating to discovery, it clearly has a wider relevance. Of particular importance is that there is no reference to "wilful default". Instead, reliance is placed on an objective standard of "excessive and unreasonable delay".

### THE CONTRIBUTION OF THE COURT OF APPEAL

The changing climate of case management received something of a setback as a result of the Court of Appeal decision in *McEvoy v Dallison* [1997] 2 NZLR 11. While case management issues do not usually get as far as the Court of Appeal and are generally best regulated by the High Court itself, this case arose essentially out of differing High Court approaches to R 426A. In the course of its judgment, the Court said (at 21):

> it has frequently been recognised that the objective of efficient administration of the Court's business must not be permitted to prejudice a party's right to a full and fair disposition of his or her cause. The dictates of fairness must prevail over the demands of efficiency .... Preventing a party from proceeding because of lack of progress is a procedural measure, and it is axiomatic today that substantive rights are not to be readily defeated by procedural means.

The very soft approach of the Court of Appeal to such matters was made clear in the subsequent decision of *New Zealand Kiwifruit Marketing Board v Waikato Valley Cooperative Dairies Ltd* (1997) 10 PRNZ 431, a case where the Court accepted that there was simply no excuse for the excessive delays which had occurred, but nevertheless granted a second application for leave to continue the proceeding.

What is ironic is that the Court of Appeal considered the proper remedy for a breach of R 426A to be the imposition of a timetable order, noting that there is an "effective sanction" for such orders in the form of R 277. In other words, failure to comply with a timetable can be policed by imposing another one. Failure to comply with that order will, traditionally, only result in an adverse costs award.

The other irony is that, in respect

***the Court of Appeal decision dampened the efforts of a number of Masters and Judges to develop a more efficient approach to litigation under R 426A***

of its own procedures, the Court of Appeal has imposed a rigorous new approach under the Court of Appeal (Civil) Rules 1997 and the accompanying Practice Note. Included in these rules is a provision which deems an appeal to be abandoned if no application for a fixture has been made within six months. There is no discretion to allow the appeal to proceed unless an application is made prior to the expiry of the period.

There is, therefore, something of an inconsistency between the case management procedures considered appropriate for the Court of Appeal, and those deemed appropriate for the High Court. Not only has the Court of Appeal decision dampened the efforts of a number of Masters and Judges to develop a more efficient approach to litigation under R 426A; the authority of the general pronouncement has also made the transition to a case management culture much more difficult. It will not be easy to have this question revisited by the Court of Appeal, as demonstrated in *Wyeth (NZ) Ltd v Anchor Products Ltd* (1997) 11 PRNZ 479; the initiative will therefore have to come from High Court Judges.

### CASE MANAGEMENT CULTURE

In his article "Case Management in the New Zealand Courts" (1998) 9 Otago LR 319, Hansen J makes it clear that case management is a feature of litigation which is here to stay. It is also clear that it requires a completely different approach to litigation, and that traditional ways of doing things are no longer going to be adequate.

Case management can only operate properly, however, when it is an accepted part of the legal culture, which is why the Courts have to be attuned to complaints of non-compliance. Although the case management culture has undoubtedly become much more pervasive in New Zealand over the past few years, there are still serious difficulties, as illustrated by cases such as *Prokofyev*.

Such cases are not going to be solved simply by awards of costs. For a start, as pointed out by Hansen J, it is simplistic to assume that the only costs involved are legal fees (at 335). In any delay, or additional interlocutory procedure, there are also client costs, opportunity costs, and public costs which remain uncompensated. In *Prokofyev*, Young J referred to the admonition of the English Court of Appeal in *Arbuthnot Latham Bank Ltd v Trafalgar Holdings Ltd* [1998] 2 All ER 181. At 191, the Court said:

> Litigants and their legal advisers, must therefore recognise that any delay which occurs from now on will be assessed not only from the point of view of the prejudice caused to the particular litigants whose case it is, but also in relation to the effect it can have on other litigants who are wishing to have their cases heard and the prejudice which is caused to the due administration of civil justice.

This means that a much broader consideration of issues is required in order to decide on an appropriate course of action.

Secondly, costs awards, especially in interlocutory applications, have tended to be modest. Although there is certainly a move towards more realistic awards in non-compliance situations, there is no obvious trend towards ascertaining what the actual wasted solicitor client costs amount to. That has to be the starting point of the inquiry. Ultimately, though, there has to be more than the threat of costs, while still allowing the proceeding to limp on. The recognition that solicitors should bear liability for costs where they are responsible (as in *Prokofyev*) is an important step, but the Court must be prepared to go further if necessary.

The traditional approach holds that the Courts will only take more drastic action where there has been "contumacious or contumelious" default. These antiquated labels have slightly different connotations. According to the *Shorter Oxford*, "contumacious" means "obstinately disobedient to authority", while "contumelious" means "scornfully insulting, insolent, reproachful". Both words, however, appear to be used to indicate some intentional flouting of a Court order. If that is the case, the threshold is far too high. It is virtually unheard of, at least for a legally represented party, to engage in behaviour which could be described as "thumbing its nose" at the Court (assuming anyone does still thumb noses). Nor is that the appropriate starting point to consider striking out a claim.

That is why cases such as *Prokofyev* and *McEvoy v Dallison* start from the wrong premise. In a case management culture, everyone is expected to comply with timetables as a matter of course. Deliberate flouting of such an order would not even be dreamt of. The situation in most cases of non-compliance is on a continuum between reasonable and explained delay of short duration, and delay which is excessive, unreasonable and unexplained. The approach posited by Cartwright J in *Hopman v Peka* seems to be the correct one: if delay is excessive and unreasonable, there is justification for striking out.

This approach can also be seen in the recent English Court of Appeal decision in *Arbuthnot Latham Bank Ltd v Trafalgar Holdings Ltd* [1998] 2 All ER 181. Lord Woolf MR said (at 191):

> We think that the change in culture which is already taking place will enable Courts to recognise for the future, more readily than heretofore, that a wholesale disregard of the rules is an abuse of process .... The more ready recognition that wholesale failure, as such, to comply with the rules justifies an action being struck out, as long as it is just to do so, will avoid much time and expense being incurred in investigating questions of prejudice, and allow the striking out of actions whether or not the limitation period has expired.

Although Lord Woolf is a major protagonist of reform in this area, it is clear that case management is bringing about radical rethinking of the established law in the area, and that traditional notions can no longer be taken for granted.

Obviously, a case management culture does not come into existence overnight, but the process in New Zealand has already been in train for many years. It is clearly indicated in 1993 judgment of Fisher J in *Kamo Sports & Dive*. Since then, case management practices have been introduced in a number of Courts and the High Court Rules have been amended to provide for exchange of evidence. What remains crucial is the role of the Courts. This is important in two respects: first by remaining in touch with litigation and by setting realistic timetables with the cooperation of the parties; secondly by taking a rigorous approach to enforcement.

There is no doubt that costs awards will remain the most important sanction for non-compliance with orders, but those awards need to be substantial in order to indicate the Court's primary adherence to case management objectives. There are undoubtedly indications that the Courts are moving in this direction. The Courts also need to make litigants aware that they do not have an absolute right to the resolution of their disputes in the Courts. Courts are scarce public resources, and need to be used responsibly. Where parties fail to comply with the demands of case management, they cannot expect the system to be unreasonably indulgent. Any period of grace for this phasing in of a new approach must surely be nearing an end; the warnings of the Courts have to be backed up by action. It is vitally important, however, that there be some measure of consistency, and that the Courts as a whole ensure that the case management approach is effective.

## SOME PROCEDURAL ASPECTS

It would be unfortunate to conclude this discussion without reference to some other issues which have arisen in case management decisions. One concerns the necessity for sealing orders before there can be a striking out for non-compliance. This was suggested by the Court in *Upper Clutha Transport Ltd v Bank of New Zealand* 4 December 1997, Master Thomson, HC Wellington CP 920/91 (an issue not dealt with in the review of that decision by Gallen and Doogue JJ on 13 May 1998). In *Lees Trading Co*, Young J expressly disagreed with that conclusion, holding that R 277 can be invoked in respect of an unsealed order.

It is suggested that Young J's approach is correct; it would be unduly technical and costly to insist that every case management order be sealed. The rules relating to sealing do not, however, fit neatly into a case management system. While sealing is not generally required of a timetable order by virtue of R 268(b), many procedural orders would not be covered by R 268 and would therefore be required to be sealed under R 267. Rule 277 does not require sealing as a precondition of enforcement, and the application of R 542 to interlocutory orders is problematic (see *Bell-Booth v Bell-Booth* (1998) 11 PRNZ 624). Some redrafting appears to be needed.

The other issue which arose briefly in *Lees Trading Co* was whether a claim which had been struck out under R 277 could be brought again within the limitation period. This argument is one of the reasons the Courts have always been reluctant to strike out for want of prosecution before the limitation period has expired. It has also been suggested that a plaintiff barred under R 426A could begin again: *Asda Holdings Ltd v Kiwicorp Group Ltd* (1993) 7 PRNZ 284. From the statements made by the Court of Appeal in *Arbuthnot Bank*, however, it is clear that the traditional approach is not set in stone.

While not resolving the issue, in *Lees Trading Co*, Young J suggested that a plaintiff could not commence the same proceeding again where it had previously been struck out for contumacious disregard of a Court order. He did not specify the basis for this, but it would presumably be seen as an abuse of process. The question is not an easy one, but ultimately it raises exactly the same policy issues as any sanction for case management. The answer must be that, once a party has been disallowed from proceeding in the Courts, it would be entirely inappropriate to permit a fresh proceeding on the same basis. Nor is this limited to situations of contumacious disregard; the important factor is the Court decision that the litigant is no longer entitled to carry on. This is the view of the English Court of Appeal in *Arbuthnot Latham Bank*, where it is suggested (at 192) that the matter is within the discretion of the Court, taking into account any excuse for previous misconduct.

The conclusion may be reinforced by considering the position of defendants. Where a defence is struck out, judgment may be entered for the plaintiff and that brings the matter to an end. To ensure equality of treatment, the most appropriate course of action might be to give judgment for the defendant rather than striking out a claim where it is clearly intended that no future proceeding should be permitted. ❑

# TAX ISSUES FOR THE CHARITABLE SECTOR

*David McLay, Bell Gully Buddle Weir*

*explores some controversial issues*

The essence of a well-constructed and operated tax system is that it is fair and is seen to be fair. There are a number of aspects of the New Zealand tax system which do not achieve the required standard in their effects on the charitable sector.

The main areas of perennial concern are:

- Rebates for donations made by individual taxpayers;
- Deductions for donations made by corporate taxpayers;
- Non-refundability of imputation credits received by charities.

There is also a recent issue relating to the structuring of family trusts, which may well prove to be no less significant.

## DONATIONS REBATE

Tax relief in relation to charitable donations made by individuals was first provided by a form of a tax deduction. Then in 1978, the form of relief was changed to a rebate, so that the tax effect of a charitable donation of $1.00 was the same for all taxpayers, irrespective of their individual marginal tax rates. (At that time, marginal rates ranged from 16.75 to 58.5 per cent, with 19 different rates, unlike today's two rates of 19.5 and 33 per cent.)

A new procedure for the claiming of the rebate was enacted in 1998 in the context of so-called "tax simplification reforms". Those reforms removed the requirement for most employees to file income tax returns by increased reliance on the withholding of taxes on employment income and interest and dividends. The new procedure is contained in s 41A of the Tax Administration Act 1994. It will apply for the 1999-2000 income year. A rebate claim form will need to be filed by 30 September following the end of the income year as the rebate will not be able to be claimed on the income tax return form. It is important to note that the new procedure will apply to all types of individual taxpayers.

In the writer's view, the enactment of a special procedure for the claiming of charitable donation rebate refunds indicates that government considers that the rebate is an important social tool.

The charitable donations rebate is available only where the gift is made either (a) to an organisation whose funds are "applied wholly or principally to charitable, benevolent, philanthropic, or cultural purposes within New Zealand", (b) to a body maintained exclusively for those purposes, or (c) to one of the donee organisations listed in the provision without the purpose test applying. In *Molloy v CIR* (1981) 5 NZTC 61,070, 61,072 (CA) the Court of Appeal noted that the statutory language relating to the requisite purposes was concerned with the manner of application of the whole or principal part of the funds of the donee, not with tracing the particular donation to an approved use. The Court also noted that the requisite purposes extended beyond the (restricted) legal view of charitable purposes, by the references to "benevolent, philanthropic, or cultural purposes". It is therefore the case that the range of permitted donees is wider than the class of entities which qualify for exemption from income tax on the basis of their being a charitable organisation.

The requirement that the relevant donee have New Zealand purposes is of some importance. Those donee organisations which are not able to satisfy this requirement must instead seek inclusion by Parliament in the list of named donees. That list contains a diverse collection of organisations which have significant overseas purposes. The process of parliamentary inclusion is a spasmodic but regular one. (There was at least one donee organisation added to the list by enactments in nine of the 13 years from 1983 to 1995 and there were up to five organisations added in some years.)

The rebate is subject to a maximum limit, which is currently $500, contained in s KC 5(2)(b) of the Income Tax Act 1994. Governments have often benefited from "fiscal drag" where tax rate thresholds have not been adjusted to take account of the effects of inflation. The stable tax rate structure over the past ten years (which has had few tax brackets) and the generally lower rate of inflation over recent years has meant that the need for constant reviews of tax rates diminished. Unfortunately, at the same time, there has been irregular reviewing of the maximum amount of the charitable donations rebate.

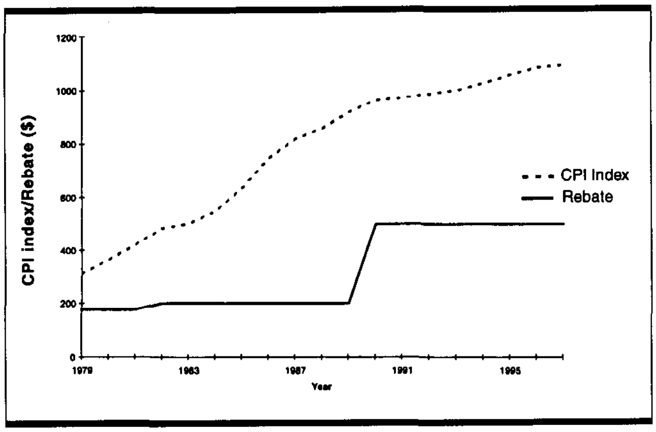
The overall effect of the lack of attention to this matter has arguably been compounded by the perceived progressive movement of responsibility for the provision of social services from central government (and local government) to the charitable sector in all its guises. The position is vividly demonstrated by the following graph.

The Finance and Expenditure Select Committee heard two submissions in 1998 about the real value of the rebate from the Inter Church Working Party on Taxation and from Philanthropy New Zealand when the Committee was considering the "tax simplification reforms". There was a lively debate for a few minutes at the Select Committee, but Standing Orders precluded the Committee from any real consideration of the matter or from reporting on its views.

There are a number of alternatives which could be considered. Those alternatives are:

- Maintain the status quo;
- Remove the limit entirely (as suggested by one MP during the Select Committee hearing in 1998);
- Increase the maximum permitted rebate to a more realistic amount and enact a regime providing for automatic indexation of the amount of the maximum rebate;
- Enact a series of new maximum amounts of the rebate for the next five years, progressively taking the amount of the rebate from the present $500 to a significantly greater amount. (A similar approach was adopted some years ago in relation to the (then) estate duty threshold contained in the First Schedule to the Estate and Gift Duties Act 1968.)

The reality is stark: in the writer's view, Parliament has abdicated its responsibility for ensuring that the level of the charitable donation rebate keeps pace with inflation.




## CORPORATE DONATIONS

Section DJ 4 of the Income Tax Act is a special provision permitting corporate taxpayers to make charitable donations. The deduction is not permitted to be claimed by a "close company", being a company with five or fewer persons (including their associated persons) holding more than 50 per cent of the shares. The same types of gifts must be to the donee organisations which are stipulated in the individual donations rebate provision.

Again, there is a maximum limit on the extent of the tax-relieved gifting. The structure of the limitation is confusing (to be euphemistic). Each individual donee cannot receive more than one per cent of the donor's net income (or $1000 if that is greater) while the total of all gifts cannot exceed more than five per cent of the donor's net income (or $4000 if that is greater). If the making of charitable donations was a "bad" activity, one could understand these restrictions. However in the context of the social good which can be achieved by charitable donations, the restrictions must be seen as simply paternalistic.

There was some quite stringent enforcement of the percentage limits during the 1980s by Inland Revenue investigators. Such enforcement may have arisen because it was an easy issue to review. In my view, that may be one reason for companies considering other means of ensuring deductibility of their expenditures. A second influence may have been a statement made by Inland Revenue itself.

> If a business cannot deduct expenditure in the form of sponsorship as a gift, it may be deductible as advertising expenditure under ... the general deductibility section. However, to be covered by this section there must be a sufficient relationship between the expenditure and gaining or producing assessable income.
>
> (*Tax Information Bulletin*. Vol.6, No 4, p 1 (October 1994))

The puzzling aspect of the first sentence of this extract is that the general deductibility provision is usually the first "port of call" for determining deductibility, with the specific provisions addressing issues not appropriately covered by the general provision. In the writer's experience, it is extremely rare for such a hint to be contained in an official Inland Revenue publication. Perhaps it is not entirely surprising that Inland Revenue in early 1998 released a redraft of an Interpretation Statement (IS 3229[r]), which will replace that Tax Information Bulletin item.

There is, of course, no monetary restriction on the amount of sponsorship expenditure which may be claimed as a deduction by a taxpayer, except to the extent that the current entertainment expenditure rules apply. However, market forces seem to create a selection bias in favour of cultural activities rather than social welfare activities. There is a requirement that there be some nexus between the sponsorship expenditure and the business or income-generating activity; cultural sponsorships seem to "fit the bill".

There is anecdotal evidence suggesting that the effect of the proviso to s DJ 4 has been to create an incentive for companies to provide "public good" funding by means of sponsorship arrangements rather than by charitable gifts. The corollary of that position is that certain types of charitable organisation, principally those involved in cultural activities, have been effectively preferred by the tax system over charitable organisations which are engaged in health and welfare aspects.

## IMPUTATION CREDITS

The New Zealand imputation credit regime was introduced in 1988 at the same time as the controlled foreign company and foreign dividend withholding payment ("FDWP") regimes.

The overall purpose of the imputation regime was to eliminate the double taxation of corporate profits, which arises through the taxation of the company's profits and the subsequent taxation of dividends received by shareholders. The imputation credit regime is designed to ensure that the rate of taxation paid in respect of the earnings of a company are taxed at the rate applicable to the recipient shareholder. The first announcement of the (then) proposed regime in the 1985 Budget included the statement that:

> the objective will be to tax, as far as possible, income derived through companies at the tax rates of their shareholders. Dividend income received by shareholders will be assessable in shareholders' hands, but a credit will be allowed for company tax previously paid.

It was decided that imputation credits would not be able to be refunded to taxpayers but that FDWP credits could be so refunded.

The imputation credit regime is designed to ensure that the rate of taxation paid in respect of the earnings of a company are taxed at the rate applicable to the recipient shareholder. However that has not been translated into any provisions achieving that objective for New Zealand charities which hold shares and receive imputed dividends. The charitable shareholder, in effect, bears a 33 per cent tax impost (being the corporate tax paid by the company). No refund of imputation credits is available.

In 1993, the foreign investor tax credit ("FITC") regime was introduced, under the name of the non-resident portfolio investor tax credit regime. It applied only to non-resident investors with interests of less than ten per cent in a New Zealand-resident company (non-resident portfolio investors). The regime was extended in 1995 to encompass all non-resident investors in shares in New Zealand companies. It applies to dividends paid on or after 12 December 1995. The precise operation of the FITC regime is outside the scope of this article. However the overall effect is that overseas investors receive a supplementary dividend which has the effect that the profits of the company which are distributed to them are only subject to 33 per cent tax in aggregate.

The perception of charitable investors is that foreign investors are being preferred, despite the fact that they only provide a benefit to our financial markets (by facilitating the raising of equity capital) rather than to the whole of New Zealand (in a societal and economic sense).

## FAMILY TRUSTS

A recent (and highly publicised) draft Public Ruling by Inland Revenue concerning the forgiveness of debt to family trusts may have an adverse impact on charities.

Under the financial arrangements accruals rules, forgiveness of debt will generally give rise to assessable income to the debtor (which benefits from the forgiveness of debt). The full scope of that rule is ameliorated in the case of forgivenesses made by natural persons "in consideration of natural love and affection" (s EH 4(6), Income Tax Act 1994). The recent draft Public Ruling indicates that it is necessary that the primary beneficiaries of a family trust which is receiving the benefit of a debt forgiveness are individuals. The tenor of the draft Public Ruling indicates that it may be desirable for family trusts to be established without there being any possibility of charities benefiting under the trust deed. In the writer's view, that is an unnecessarily restrictive approach to the language of the "natural love and affection" requirement, because charities are often secondary beneficiaries.

The approach of Inland Revenue is also reflected in the proposed amendments to the accruals rules contained in proposed s EH 49 contained in cl 21 of the Taxation (Accrual Rules and Other Remedial Matters) Bill 1998, presently before Parliament.

The effect of the Inland Revenue initiatives is that there is likely to be a preponderance of new family trust deeds having no possibility of charities being beneficiaries.

## REASONS FOR INACTION

In each of the three perennial problem areas addressed above, there has been inaction by government. What are the reasons? Some suggestions are:

- The tax reform programme commenced in 1985 has focused attention on new regimes (and their repair) and on the rewrite of the Income Tax Act.
- The unregulated nature of the charitable sector seems to be a concern, even though the deregulation of most sectors of the economy has been the trend.
- There is a possible impediment in the capacity of charitable organisations to lobby for appropriate changes.

### Tax reform programme

The tax reform programme commenced in 1984/85 with the introduction of Fringe Benefit Tax and GST. Since that time, there have been numerous new regimes introduced, including:

- Financial arrangements accruals regime (1986);
- International tax regime (comprising the Controlled Foreign Company and Foreign Investment Fund provisions) (1988);
- Trust tax regime (1988);
- Superannuation and life insurance regime (1990) and the tax credit system (1998);
- Entertainment tax (1991) and its modification (1995);
- Depreciation regime (1993);
- Tax penalties regime (1995);
- Tax disputes regime (1995);
- Thin capitalisation and transfer pricing rules (1996).

The effect is that some difficult issues, like the position of charities, have been left unattended. Most of the new regimes have been complicated and have required considerable effort (in terms of time and resources) to be enacted. In addition, there is the rewrite of the Income Tax Act. Although the rewrite of the Act is intended to act in a remedial manner, there does appear to be a focus on tax base protection issues.

### Unregulated nature

Although this article is intended to address the taxation issues affecting the charitable sector, it is impossible to omit mention of the unregulated nature of the sector. It is mentioned not for the purpose of suggesting regulation of the style of the Charities Commission of the United Kingdom, but rather to note an undercurrent that the lack of regulation means that there is the possibility of abuse. It is important that we do not fool ourselves: the possibility of utilising tax-exempt charitable trusts in tax avoidance arrangements does exist. However identification of that possibility overlooks the fact that charities are subject to the possibility of control by the Attorney-General and the Courts.

### Lobbying

The charitable sector arguably suffers from a lack of centralised lobbying effort on general issues such as taxation. There are few umbrella organisations. Philanthropy New Zealand (formerly known as the New Zealand Association of Philanthropic Trusts) represents grant-making charitable trusts, while New Zealand Federation of Voluntary Welfare Organisations (Inc) represents the providers of welfare. There are other bodies in specific sectors, such as Federated Early Childhood Education Organisations of NZ.

There are unfortunate legal constraints on charities being involved in lobbying activities. It has been stated many times by the Courts that it is not a charitable object to seek legislative changes. Such statements have been made most forcibly in the context of the Anti-Vivisection Society, and also in respect of the Society for the Protection of the Unborn Child (*Molloy v CIR*). In the latter case, it was also stated that seeking the preservation of existing law was not charitable, because that, like seeking legislative change, is a political activity. This aspect should not be overstated, but it may account for some of the difficulties.

## CONCLUSIONS

In the writer's view, it is now well and truly the time for action on the individual donations rebate and on the refundability of imputation credits for charitable shareholders. In addition, it would be desirable for the corporate donations deduction provision to receive review. ❑

# RETIREMENT VILLAGES

*David Brown, Victoria University of Wellington*

***explores the limits of charitable relief of poverty in a welfare state***

From its earliest inception, charity has included relief of the "aged, impotent and poor". Of course, the concept of poverty is relative and varies over the years, and what counts as "aged" has also varied over the course of history. Consequently, "relief" of the trappings of old age, and relief of poverty, can take many forms.

Thus in the early 1990s, when "Names" at Lloyd's lost considerable fortunes, the attempt to register a hardship fund as charitable met with failure. Notwithstanding that poverty was relative and that there was authority that a trust for gentlemen who had fallen on hard times was charitable, the Charities Commission in the UK did not feel that the Lloyd's fund fell within relief of poverty, bearing in mind the high minimum capital requirements for becoming a Name.

As far as relieving the hardships of age is concerned, the question has largely turned on the element of "relief" and how far financial hardship is required. Not all elderly people need money. They may, however, need specialist care, counselling, security and companionship, and the provision of these services should be within the definition of charity.

Providing long-term residential care for the elderly is now big business. Retirement villages are springing up. The population is getting older and will continue to do so. The Law Commission's recent *Preliminary Paper on Retirement Villages* (PP 34, October 1998) contains statistics (Appendix A) suggesting that the proportion of those over 85 has risen from 4.8 per cent of the elderly population (those over 65) in 1956 to 9.1 per cent in 1996. By 2050 they are expected to constitute around 22 per cent of the elderly population. The Law Commission paper, though largely concerned with providing protection for those who buy into such villages, and the relationship with the Securities Act 1978, nevertheless recognises the growing importance of such villages, and acknowledges that special protection is needed by way of some disclosure of investment risk for elderly people participating in new retirement village projects. Of course, most such villages are not run as charities. On the other hand, some of those which have, or have sought, charitable status have made a charge for some aspect of the accommodation and other services being provided. This article looks at a recent decision of Hammond J, *D V Bryant Trust Board v Hamilton City Council* [1997] 3 NZLR 342, and of the Court of Appeal, *Hamilton CC v Bryant* [1997] 1 NZLR 41, in which the issue of whether some element of payment was incompatible with the charitable status of a retirement village, was determined in the context of rating exemption.

## THE FACTS

The case concerned an established retirement village in Hamilton, built in 1967 as one of many schemes by the DV Bryant Trust Board, a major benefactor in the Waikato area. The Board itself is a registered under the Charitable Trusts Act 1957 and was established for the purposes (inter alia) of providing and maintaining "homes, hostels and other accommodation for the care and benefit of men, women and children".

The particular home in question, Bryant Village, was described by the Judge as a "twilight community", and in the promotional literature as being "delightfully situated overlooking the St Andrews Golf Links" with "a rural outlook". The 28 units were self-contained and furnished, with modern appliances apart from linen, crockery and cutlery. In addition, there was a social hall with a hobbies room, a magazine and book library, and "croquet on the lawn in the summer months". This village was predicated on the idea that its residents would be self-catering and look after themselves, so that not only was there no nursing or similar facility on site, the policy of the Board was that people over 80 or those who could not look after themselves, would not be encouraged to apply, and if anyone got into a state where they could no longer care for themselves, they would have to leave the village.

Rent was payable for accommodation, and the current policy was to charge 36 per cent of the national superannuation single benefit. Thus, in furnished rooms, residents paid $90, in unfurnished rooms, $88, and $6 for a carport. It was agreed by all parties that this was still well below market rates. The link to national superannuation meant that residents nearly always had the ability to pay. There was a waiting list for entry, and the secretary of the Board stated that entry was determined on the basis of need, usually relating to existing living circumstances and the desire to live in a village where "umbrella care" was provided.

Notwithstanding that residents could usually afford to pay, the Board's written policy was that residents would be admitted irrespective of inability to pay, and that no charge would be made in a case where payment would involve hardship. In the history of the village, there had only been two occasions, each involving the same person, where an application for some element of reduction had been made. The link with superannuation meant that it was going to be rare for a resident to be unable to pay, unless there was a change in government policy.

The Board did not wish to charge sums which made a return on capital, but merely wished to recover running costs. It regarded the capital provision as a service to the community.

## THE ISSUES

Between 1967 and 1993 the land on which the village stood was treated by the Hamilton City Council as non-rateable. In 1993 the council had an "internal review" and took the view that the property should be rateable. Differences were irreconcilable, so the Board applied to Court for a declaration that the property was not rateable.

Section 6(1) Rating Powers Act 1988 states that land in Part II of the First Schedule shall be deemed non-rateable, and cl 5 of that Part includes:

(1) Land used and occupied by or for the purposes of a charitable institution which is carried on for the free maintenance or relief of orphans or of the aged, infirm, physically or mentally disabled, sick or needy, but not exceeding 1.62 hectares in respect of any such institution.

(2) For the purposes of this clause, an institution shall be deemed to be carried on for the free maintenance and relief of such persons if it complies with the conditions specified in s 179(4) of this Act.

Section 179(4) provides that "free maintenance or relief" should be given an extended meaning if:

(a) Inmates are admitted irrespective of their ability to pay for maintenance or relief; and

(b) No charge is made in any case where payment of the charge would involve any hardship upon the inmate or upon any other person.

In 1995 the village increased its charges to allow for the possibility that the village would become rateable, and the sum involved would be $15,000 per annum.

The issues for determination were:

(i) whether the land was used for the purposes of a "charitable institution";

(ii) if so, whether it was carried on for the "free maintenance or relief of the aged" as defined in s 179(4) and

(iii) whether the land was less than 1.62 hectares in area. (Although the area exceeded that amount by eight square metres, the 1988 Act provided for apportionment. While Hammond J remarked that the "the council would be entitled to its ounce of flesh on apportionment were it to stand on its legal rights", the council in the Court of Appeal did not contest His Honour's conclusion that the eight square metres could be apportioned if the council so wished.)

## WAS IT A CHARITABLE INSTITUTION?

It was not conceded by the council before Hammond J that the village was a charitable institution, notwithstanding that the Board itself was a registered charity. Hammond J referred to the preamble to the Statute of Elizabeth 1601, as well as the four-fold classification of Lord McNaghten in *Commissioners for Special Purposes v Pemsel* [1891] AC 531. Lord Wilberforce in *Scottish Burial Reform Cremation Society v Glasgow Corporation* [1968] AC 138 had stressed that the classification was one of convenience and must not be given the force of statute.

Hammond J confirmed that charities law should not stand still. It should keep abreast of changing institutions and societal values in New Zealand. Nevertheless, a "cautious approach" would be adopted, proceeding by analogy but not allowing new charities to "spring up overnight".

He viewed the village as coming under three possible limbs. "Relief of the aged, impotent and poor" were the opening words of the Preamble and the "heart" of charities law. Those words are to be read disjunctively: it is not necessary to be aged, poor *and* sick to benefit (see *Re McIntosh* [1976] NZLR 308). Hammond J regarded this institution as falling within relief of poverty, relief of the aged, or under the "fourth head", Lord McNaghten's "other purposes beneficial to the community".

## RELIEF OF POVERTY

Poverty is a relative term and is not to be equated with destitution. The question was how far a charge for provision of services, by way of rental or otherwise, prevented an institution from being for the relief of poverty. His Honour referred to a Canadian case involving an old persons home where a small charge was made, the Crown there arguing that it was "nothing more than a high class boarding house". However, it was held that it fell within the relief of poverty or the fourth head (*Protestant Old Ladies Home v Provincial Treasurer of Prince Edward Island* [1941] 2 DLR 534).

In *Rowntree v Attorney-General* [1983] Ch 159 it was held that charging for services was not incompatible with the notion of charity. But *Rowntree* was decided on the basis of relief of the aged. In *Re Resch* [1969]1 AC 514 Lord Wilberforce had stated that charities for the relief of sickness, age, or indeed for the advancement of religion or education, did not have to be targeted at the poor sick or the poor aged. However, in dealing with a case where private medical facilities were provided at fees which were not low, Lord Wilberforce was of the opinion that a trust for such facilities which deliberately excluded *all* poor people might well be held not to be charitable on grounds of insufficient public benefit. (This has always seemed to me to be difficult to understand. Generally, insufficient public benefit in this context means that those benefiting are a narrow section of the community such as relatives or employees, or that there is merely a self-help purpose. That can hardly be the reason for refusing charitable status to a fund for "everyone in New Zealand who is old as long as they are not poor". It must be refused on grounds of an unarticulated public policy along the lines of insufficient altruism.)

In this case, Hammond J seemed to be of the view that there was an element of relief of poverty by the provision of amenities to the elderly for a price linked to superannuation benefit. However, His Honour did not really put his decision on ground of "relief of poverty".

## RELIEF OF THE AGED

The argument was about the meaning of relief. What is meant in this context is that the provision should relieve the incidents of old age, since nothing can yet be done about the fact of age itself (unlike poverty). As Peter Gibson J pointed out in *Rowntree*, a gift of money to the aged millionaires of Mayfair would not relieve the incidents of age. There are authorities to the effect that provision of amenities is not enough to show "relief", in the context of relief of poverty. In *Re Cole* [1958] Ch 877, it was held that entertainment in a children's home was not relief of poverty, even if the children were poor. His Honour said that a Court having more concern for the plight of children might take a different view. In *Re Mitchell* [1963] NZLR 934 it was held that provision of "creature comforts" was valid. Indeed in *McIntosh* Beattie J declined to follow *Mitchell*, and distinguished the "creature comforts" in that case which, on construction of the bequest, were clearly intended to be over and above necessities from the "comforts" provided to patients in hospitals which were normal care, recreation and recovery of patients in the case before him. In addition, Beattie J pointed out that *Cole* had been criticised by *Tudor on Charities*, where Lord Evershed MR's dissenting judgment was approved. While Hammond J in *Bryant* surprisingly makes no reference to *McIntosh*, that earlier decision of the Supreme Court enhances his views on the type of relief in the case before him. The essential test is not one of providing "benefits" or amenities, but of providing "relief".

In any event, Hammond J held the facts of this case went far beyond creature comforts, in that the village provided for the "deepest kind of human needs". Modern governmental provision did at least provide for the basics of food, shelter and medical care, but, echoing King Lear, His Honour stated that "what we need just to survive, and what human beings need to flourish and to continue to grow (even in old age) are quite different things". The fact that there were no nursing facilities was not fatal.

People live longer now, so the "aged" get older. In *Re Wall* (1889) 42 Ch D 510 it was held that being over 50 was aged, a proposition not received by Hammond J "with any enthusiasm". While the Bryant Village usually excluded the over 80s, most of its residents were in their seventies. His Honour would have declined to follow *Re Wall* had it been necessary to decide the point.

His Honour eschewed the desire to get into a political debate about governmental provision and the welfare state, but did say that the argument for the council that the aged in this village were not "relieved" by the services provided and the very concept of the village community was "not just wrong in law but downright churlish".

The spectre of a retreat of the state, coupled with a harsh view of the law of charity, is unthinkable in both human and legal terms.

His Honour said that the question was twofold, was there a need to be relieved against, and was it more than fanciful or insubstantial? The need in this case was a real need, albeit a human one rather than a tangible one. The fact that it was a human need, for companionship, was no less important than spiritual and artistic needs provided for under other charitable heads.

## BOUNTY NOT BARGAIN

As for the maxim that charity should be "by way of bounty, not bargain", *Rowntree* has shown that this generalisation goes too far. There is plenty of authority that payment by those benefiting is not fatal to charitable status, as fee-paying hospitals and schools illustrate. There is still a need for bounty, despite the presence of bargain, so that the purpose must still fall within a recognised head of charity, and any payments must be regarded as incidental to the provision; secondly, it should not amount to a mutual contract for entitlements amongst a group. For example, a housing cooperative amongst a group of elderly people, who were contractually entitled to dwellings in return for payments, and where the total capital and running costs were met by them collectively, would be unlikely to be charitable just because they were elderly. In *Rowntree* the elderly residents made a capital contribution in return for long leases, and there was evidence that some of them would even recover more than they had contributed. Peter Gibson J nevertheless held that this was not fatal, provided the institution did not make a distributable profit. Thus in *Bryant*, where rentals well below market value were charged, it was not really arguable that payment should defeat charitable status, especially as the residents were not making a contribution to the capital cost of the village. Clearly a service beneficial to the community was being provided at no cost to it.

## PURPOSES BENEFICIAL TO THE COMMUNITY

The fourth head, being residual, and being determined by analogy with past precedent and the spirit of the Preamble to the 1601 Statute, is inevitably more diverse. While all charitable gifts and institutions must satisfy a separate "public benefit" test (which in the context of this head of charity means that those benefiting must not be too narrow a section of the community) in the case of the fourth head there is an inherent prerequisite of public benefit at the first stage. Hammond J stated that relief of "distress" of various sorts had been held within the fourth head, and there was a clear relationship between distress and poverty. Secondly, the board has provided, free of capital cost to society, a village with a wide geographical catchment area and a potentially large number of beneficiaries. It was beneficial to the community because if individuals, collectives or philanthropic bodies did not provide this type of facility, society itself may well have to do so. Thus even if it was not for relief of poverty or age, it was probably within the fourth head.

The idea that something is "beneficial to the community" within this residual category if it is providing a service which relieves the burden on the state is supported by the history of charitable trusts in this category which, as His Honour stated earlier, is confined to "activity which supports the public weal". Many of the purposes listed in the Preamble to the 1601 Statute, and the policy behind that Statute, were concerned with relieving the burden on parishes.

Therefore one could say that (provided it is not for too narrow a section of the community for it to be labelled "public") a trust or other charitable institution will be beneficial to the community if it is doing something in the field of welfare or education which the state is doing, may do or used to do. This is controversial in so far as it extends to a decision on what the state should do, or what some governments do in these fields. Hammond J's dicta are clearly to the effect that Courts must give a reasonably wide interpretation to heads of charity in order not to discourage philanthropy at a time when there is a "retreat from the state". His views as to the role of a decent society in providing for the elderly are that "modern governmental provision may not be generous by any standard other than a comparison with the almshouses of other centuries". In other words, the state provides the bare minimum of food, shelter and medical care, so philanthropy must be encouraged to provide beyond these levels. In the field of charities, the Courts frequently stress that politics and charity do not mix, yet inevitably in this field, Courts are thrown into the relationship between the welfare state and private provision. Conferment of charitable status tends to suggest in the minds of public and government itself that an institution in the voluntary sector is more respectable than one which is non-charitable, which leads to the attraction of further governmental and private funds. While it may be said that in this case, Hammond J's comments went beyond what was necessary for his decision, at least he adverted to the political role of the Courts in this field. For example, what if the effect of a wide definition of charity in cases such as this is that the state becomes complacent about welfare provision and leaves more to the social responsibility of individuals and philanthropic organisations?

In any event, Hammond J's decision on charitable status of the Village seems correct on grounds of relief of age and also the fourth head. Given that the element of contribution was linked to the superannuation benefits and was not a capital contribution, the case seems less controversial than *Rowntree*. For that reason, the issue of the charitable status of the village was not appealed to the Court of Appeal, but the issue on the Rating Powers Act 1988 was appealed.

## WAS THE VILLAGE RATEABLE?

Hammond J took the view that the words of s 179(4) Rating Powers Act extended the plain ordinary meaning of "free maintenance or relief" so that the Board's policy of admitting residents (or "inmates", as the 1988 Act unattractively called them) irrespective of means, and of not charging, or not fully, in any case of hardship, complied with this extended meaning. It would require only one case of hardship for that to be complied with.

Secondly, "maintenance or relief" were disjunctive, so that even if it could be argued that the rental charges meant that maintenance was not free, the "relief" was free here in that the capital provision of the village and the community itself was free relief to the residents, who merely contributed to board.

Lastly, Hammond J took the view that the suggestion that the village and its residents were getting an unfair advantage was misplaced. Leaving aside any views on the merits of rating policies, the fact was that they were paying a substantial portion of their superannuation as rent, and it was all too easy for affluent people "to overlook the very significant impact of even a few dollars in the lives of superannuitants". The charity was perpetual, and the council was wrong to fix on the situation now, where there had only ever been one call on the hardship policy. Government policy may change so that there was more hardship in future. While one had to determine the rating issue now, the point met the objection that the residents were getting unjustly enriched at the expense of the ratepaying community.

The Court of Appeal broadly agreed with Hammond J on this point. Counsel in the Court of Appeal had suggested that Hammond J's distinction between contributions to maintenance and the fact of "relief" was unduly technical and inconsistent with the facts. If the residents were paying rental charges, this contributed to the use of the land and was also designed to contribute fully to the maintenance and operating costs of the village. Moreover, just because there was no contribution to capital it did not mean the accommodation was free. To the extent that Hammond J was suggesting that the "free relief" was the relief from solitude in old age, that was not free either because it was provided by the rentals of the other residents, without which there would be no companions and no village.

The Court of Appeal recognised the artificiality of separating these various aspects of village life, and agreed with the Judge that the "lifestyle associated with the village" could be described as "relief". Nevertheless, the companionship aspects could not be separated from the buildings and other aspects of the physical site, so that the Court agreed that the trust could only succeed if within the extended definition of "free maintenance or relief" provided by s 179(4). Hammond J had not had to decide whether the village provided "free maintenance or relief" within its plain and ordinary meaning, since the Board had relied before him on the extended definition in s 179(4).

Thus, the sole issue was whether the village fell within the extended definition. It was argued for the City Council in the Court of Appeal that despite the policy of the Board, it did not satisfy the two requirements on the facts, which were cumulative requirements. First, residents were not admitted irrespective of ability to pay. Residents were in receipt of superannuation, and paid a proportion of it in rental. Those who could not cope because of age or condition were excluded from the village. The brochure did not advertise any hardship provisions. Lastly, only one resident had ever called on the hardship provisions (albeit on two occasions) and that was a resident rather than an applicant for residence. In 29 years nobody had been admitted who could not pay, so that the mere statement of a policy was insufficient to comply with s 179(4)(a).

The Court of Appeal disagreed that it was a question of looking at the history of the institution, rather than its intentions as expressed in the policy. If the council's argument were correct, it would almost never be possible for an institution for the aged to qualify for rating exemption, since national superannuation was an universal entitlement and in this case, residents' payments were linked to it. The historical fact that the Board had never excluded anyone on grounds of means had to be seen in the light of the fact that the state provided nearly all appropriate residents with income related to the charges. In addition, the provisions of cl 5(2) of Part II "deemed" an institution to be providing "free maintenance or relief" if it fell within s 179(4). The nature of the activity was to be determined by its application to an individual rather than its overall operation. The deeming provision was introduced as a result of *Bay Town Board v Verdon* [1913] 15 GLR 459 where under the previous legislation it was held that a service could not be said to be provided free where the recipients paid a partial charge derived from their old age pensions.

In this case, it was accepted by the Judge that the Board would have reduced the rental charge to nil in a case of someone with no income whatsoever, and the Court of Appeal was not prepared to gainsay that evidence as the genuineness of the Board's policy. The Board's policy was deliberately couched in terms of s 179(4) so provided it was genuine, that was enough.

As for the second limb of s 179(4), the "hardship" provision, the council argued that since no resident in 29 years had been provided with free accommodation (and that even in the case of the one resident who got a partial waiver, the amount waived was "minuscule") it could not be said that there was in fact such a policy. Again, the Court disagreed, and actually said that the example of that one application did show that the Board was prepared to make reductions. The infrequency of the necessity to make reductions must be measured against the fact that the residents' ability to pay depended on their entitlement to superannuation. Without expressly stating it to be so, the implication of the decision must be that the genuine policy of the Board might be utilised more often in future should there be any change in superannuation provision by the state.

***continued on p 70***

# HEALTH CHARITIES

*Dr Boyd Swinburn, Medical Director, The Heart Foundation*

*praises the unsung players in our health care system*

The health charities are an often-forgotten and undervalued sector in the health system. The private and publicly funded primary care (mainly general practice) and secondary care institutions (hospitals) are the dominant forces but very few people realise the extent of the contribution from the health charities. My personal appreciation of their vital role in the health sector has only come about since I have been Medical Director of the Heart Foundation. Prior to that, as a hospital doctor, I had only a vague notion of the range and depth of their work. While their overall dollar contribution may be small, the added value of the tight focus of each agency and the high level of commitment by the professional staff and voluntary workers means that their overall impact is substantial.

The range of charitable agencies is wide and their "constituency", the people whose health they are trying to improve, often have a specific disease or set of diseases, such as heart disease, cancer, asthma or arthritis, or a disability, such as blindness or physical handicaps. However, all the agencies have evolved "from the bottom up" as a section of the community has mobilised to fill a need that was not being catered for by the main stream health providers. They also have another feature in common – they are all dependent, to a greater or lesser extent, on the public for their income through donations, bequests and support for all manner of fund-raising activities. The energy needed to raise funds is always substantial and most agencies are desperately under-resourced.

I will draw on my experience with the Heart Foundation to give my perspective of the contribution and worth of the charitable health sector and to define some the challenges which lie ahead for them.

## THE HEALTH IMPACT OF CHARITABLE AGENCIES

Charities are involved in most facets of health care as illustrated in the table. In general, the direct provision of health care services is not a major function of charity agencies because of the large costs involved. One exception is the disability support services which CCS provide under contract to the government. Adding value to existing health services through a variety of patient education materials and patient support services is a very important role for charities. They know their clients best and are usually well placed to meet their education needs. For example, the Heart Foundation alone publishes and distributes over $100,000 worth of health resources on heart disease and related topics. Public education and training are a mainstay of many charitable organisations and again by way of example, the Order of St John, Red Cross Society and Heart Foundation train over 130,000 people a year in resuscitation.

The public, health care professionals and the media often look to the agencies for expert independent comment on specific topics related to a current public debate, recently published scientific studies, or health claims. These seem to be particularly common in the nutrition field where new controversial findings seem to come through on a weekly basis and what the journalists and the public seek more than anything is a credible, independent opinion to help them place the issue in context.

New Zealand Governments have never been keen to invest in research and development and health research suffers accordingly. Only about 0.6 per cent of the total health expenditure goes to research compared to international recommendations of 2.0 per cent. Countries we compare ourselves to, such as Australia, Ireland and Scandinavian countries, invest twice the proportion of their health budgets into research compared with New Zealand. Many charities understand the fundamental need for a strong health research base and contribute where they are able. The Cancer Society, Heart Foundation and regional medical research trusts, in particular, place a strong emphasis on research and fund projects and fellowships worth about $6 million a year. This is a large sum to raise each year from the public and yet, when one considers that cardiovascular disease and cancers together are responsible for over two thirds of the deaths, it represents a tiny investment in the country's health. Funding of health research pays off in many ways. Obviously, it contributes to the world's knowledge and fosters breakthroughs in understanding causes, treatment, and prevention of diseases and New Zealanders benefit directly from that. However, it also contributes to the culture of learning and striving for excellence in our hospitals and clinics. This ensures that the health professionals, in whose care we place ourselves, can provide a level of care that matches international standards (when government funding allows!).

Disease prevention and health promotion are extremely important roles for the health charities, again filling the relative vacuum of inadequate government funding. Less than two per cent of the government's total health budget is spent in this area. An excellent example of the lack of commitment to prevention is the trivial funding for tobacco control. More than $650 million is raised from tobacco taxes each year, of which less than $12 million is spent on tobacco control. Even then, the majority of the money is spent on the relatively weak strategy of marketing the Smokefree brand through the Health Sponsorship Council. The health dividends of prevention are obvious but require a longer term vision and more commitment than governments are willing to provide. The charitable agencies have a record of providing that vision and commitment over the long haul. The most striking illustration of this is the decline in coro-

### Examples of health services provided by health charities

| Health services | Examples |
|---|---|
| • Health education resources | Pamphlets, books, videos |
| • Health information and inquiries | Telephone advice, 0800 lines, web sites |
| • Independent expert comment | Media responses, scientific issues |
| • Public education | Radio programmes, community education |
| • Training | CPR instruction, first aid, nutrition |
| • Patient care services | Medical supplies |
| • Disability services | Community facilities and support |
| • Patient support | Transport services, patient groups |
| • Health professional education | Clinical guidelines, seminars |
| • Health research | Research projects, fellowships |
| • Health promotion | Healthy school and workplace programmes |
| • Influencing industry | Pick the Tick |
| • Advocacy | Tobacco, nutrition, health services |

nary heart disease mortality over the past 30 years. The Heart Foundation was established in 1968 to spearhead the effort to turn around the then rising epidemic of heart disease which was killing middle-aged people in their thousands. Since that time, the mortality from heart disease has fallen by a startling 50 per cent and has been a major contributor to the 5.4 years of life expectancy gained since 1970. The decline in heart disease death rates has been achieved through a wide variety of means but with prevention measures such as reductions in smoking, improved nutrition, reductions in blood cholesterol and blood pressure accounting for the lion's share.

A further attribute of the health charities is their strong advocacy for the people they represent within the health system. Whether they are advocating for improved services for people suffering from specific diseases or disabilities or they are banding together to tackle an issue like tobacco, they can be counted on for commitment and passion. Under strong pressure from the Smokefree Coalition, the government increased tobacco tax by 50 cents in the 1998 budget. Tobacco consumption dropped by ten per cent as a result and even before the end of 1998, premature deaths would have been averted. Provided the tax rates are kept up to match inflation, the effect on consumption should remain and progressively improve "health expectancy". After about 10-15 years (by which time most of the health benefits of the reduced tobacco consumption will have been realised), over 400 premature deaths will be averted per year from that tax hike – about the equivalent of the road toll – and the government collects millions of extra tax dollars in the process!

## WHY SUCH A SUCCESS?

The health charities appear to contribute a disproportionately large amount to the health of New Zealanders compared to the dollar size of their sector. The reasons for this include:

- commitment to their cause;
- knowledge of the needs of their constituency;
- use of volunteer workers;
- strong networks;
- small size of the agencies;
- durability over time;
- independence;
- access to expertise in the area; and
- efficient use of publicly donated funds.

First and foremost, the agencies are committed to their particular cause and passion counts for a lot in a world where the mainstream health services are constantly stretched and underfunded, and government health agencies are forever restructuring. In the past six years, the Heart Foundation's contract to provide nutrition health promotion services has been handled by no less than five government agencies, with each set of initials and expensive logos seeming to last shorter than the last (for the record: DOH, PHC, RHA, THA, HFA). By contrast, the health charities have a record for durability and many are of modest size, so that administration and bureaucracy are kept to an absolute minimum.

The extensive contribution from volunteers not only for fundraising but also for the provision of services, patient support and expert advice is a key feature of this sector. This not only increases the cost-effectiveness of services but also contributes to the overall "giving, caring, supporting" culture of these agencies. The community networks constantly provide feedback to the agency so that it remains in close touch with its constituency. Combining paid health professionals, expert volunteers and lay volunteers into one coherent organisation is a constant challenge but contributions from all three groups are another key to success.

Independence and credibility are central values for the health charities. Much of the respect accorded the health charities by the public, the media and health professionals is highly dependent on these values. For example, the Heart Foundation extensively reviews the scientific literature before developing its clinical guidelines such as for the treatment of heart failure or its recommendations such as food and nutrition advice for the public. The agencies draw heavily on the voluntary time of health experts to provide this independence and credibility.

The efforts needed to raise the necessary funds for the agencies' work put the money into a clear perspective. For example, over three-quarters of the Heart Foundation's funds come directly from the public with the remainder being contracts with the Health Funding Authority. These dollars are given by individual members of the public in the clear expectation that they will be used effectively and efficiently. Agencies strive to keep administration and overhead costs down to meet this expectation and the most effective use of scarce funds is always a battle.

## STRENGTHENING CHARITIES

The constraints on a further strengthening of the health charity sector are, of course, mainly financial. There are more and more calls on the donated dollar and, in a twist of irony, the success in reducing heart disease and increasing life expectancy has meant that less money may be available for bequests to charities. Bequests to charities are sometimes challenged by relatives. The Heart Foundation has taken a decision to contest such challenges on the grounds that it was the wish of the deceased to contribute that money to the work of the Foundation and that such a wish should be upheld. The Foundation is highly dependent on this charity and we could not function without it. A lack of recognition of the work done by health charities may also mean that the public are not aware of just how dependent they are on donations and bequests.

Another option for funding is to win more government contracts. However, as mentioned above, experience with the government funding bodies is that they are forever being restructured and asked to dance to different tunes so that long-term dependence on them for major funding is a risky business. One valuable aspect of contracting, however, is the discipline of developing good budgets and tight performance measures which the Heart Foundation, at least, has carried over into other non-contract areas of its work. Sponsorship is another option and many agencies are involved in some sponsorship arrangements for projects such as education resources, facilities, and education programmes. Too large a sponsorship deal can significantly impinge on the independence (or the appearance of independence) of the organisation and that may damage its credibility or put the service at risk (such as Plunket's free phone line) if the sponsor withdraws its support. Juggling the income side of the ledger is difficult given these factors and the unpredictable nature of bequests and donations.

Picture the health sector without the work of the charities as I have described them. It would be much less caring and committed to people, and would be full of holes in important areas such as prevention, education and advocacy. I believe it is vital that the health charity sector flourishes. It is grass roots and community driven. It is the durable helper of its people. It is the independent voice and the people's advocate. It stands for scientific research, education and prevention. Funding the sector through more government or private sector money risks some of the very attributes that make the voluntary agencies strong in the first place. The continued generosity of ordinary New Zealanders remains our lifeline. ❑

---

*continued from p 67*

## CONCLUSION

This decision, which was something of a test case, has brought relief to those in retirement homes run on a not-for-profit basis, and of course to the trustees of such homes. It confirms that relief of age, poverty or sickness can be provided in many different ways, and that the concept of provision of "relief" by the voluntary sector will vary over time, and with variations in government welfare provision. It confirms that there is scope in the law of charity for fee-paying institutions, and that rating relief is available to providers of charitable homes for the elderly, sick or needy provided that there is a genuine policy not to exclude people on grounds of means, and to provide for alleviating financial hardship for those admitted.

The Law Commission was asked by the Securities Commission to look at whether retirement villages (not a legal term of art) should be excluded from the Securities Act 1978 further than exemption notices have already excluded them. (For the latest, see Securities Act (Retirement Villages) Exemption Notice 1998 SR 1998/187). The Law Commission's Preliminary focuses on the extent to which disclosure requirements should be satisfied before entering into contracts to participate in retirement villages (often before they have been built, and where a certain volume of participation determines the success of the venture). The Commission proposes a simple form of disclosure notice pre-contract, and secondly the appointment (strangely, still to be made by the Securities Commission except in corporate trustee cases) of a prudential supervisor who is to have an ongoing role in ensuring that obligations to residents are not breached, and is to have powers (along with the Registrar of Companies) to apply to Court for appointment of a manager or for directions to protect the residents' interests. The precise role of the prudential supervisor is to be left to contractual negotiation with the promoter of the village. In this respect, the Law Commission considered, but rejected, any exclusion of not-for-profit organisations from the proposed disclosure requirements. They considered that the only type of such organisations that should be excluded were the rare ones where residents provided no consideration whatsoever. The reasons for inclusion of charitable and voluntary sector villages were first, that benevolent purposes were no guarantee against financial collapse, and secondly, that charitable status in New Zealand did not protect against abuse by fraudulent schemers. In addition, the Law Commission does not propose exclusion of schemes where there is no capital commitment by potential residents, since it was easy to disguise a capital commitment as some other form of front-loaded payment. Thus its preliminary recommendations apply to charitable retirement villages as much as to commercial ones.

This is not the place to examine the Law Commission's paper on retirement villages and the problems of the Securities Act. However, in relation to charities the proposals seem a bit heavy-handed. Do all charitable retirement homes (many of which would not fall foul of the Securities Act at present) need such rigorous disclosure requirements, and the cost of a "prudential supervisor". While acknowledging that the idea is to reflect, but dilute, Securities Act safeguards, charitable and other trusts already have prudential supervisors, known as trustees. If registration under the Charitable Trusts Act 1957 cannot protect against abuse of that status, clearly that is a problem of accountability of charities which was addressed in last year's Charities supplement of this journal ("Charitable Accountability", Ireland [1998]NZLJ 49) and will no doubt continue to be addressed as a result of the ACSB Working Party set up by the Ministry of Justice. There is no reason to single out charitable retirement villages for special protection against abuse when the entire charitable sector is unregulated in this country. Elderly people may well need protection of their savings, but so do other donors and beneficiaries of charitable status. To the extent that *Bryant* shows that there are still limits on qualification for charitable status, the Law Commission's proposal, while it may be a reduction in costs to commercial retirement villages, does not adequately explain why this particular sector of charitable activity should be subject to this level of regulation more than any other. ❑

# INCORPORATED CHARITABLE TRUSTS

*Kerry Ayers and Daniel French of Helmore, Macdonald & Stanley*

*assess potential liabilities under the Charitable Trusts Act 1957*

The trustees of a charitable trust, or the members of an unincorporated society formed for charitable purposes, may incorporate themselves as a Board under the Charitable Trusts Act 1957 (the "Act"). The Board which results is a body corporate consisting of the trustees of the trust or the members of the society (as the case may be) from time to time (s 11(2)).

All property held by trustees or a society prior to incorporation automatically vests in the Board upon and subject to the existing trusts, contracts, and equities (s 14). Presumably any trust deeds or contracts (the "constitution") must be interpreted to fit the new arrangement as far as this is possible (eg trustee appointment clauses in a trust deed will upon incorporation be interpreted as providing for the appointment of new members of the Board.

The principal advantages of incorporation are that the Board has perpetual succession and separate legal personality (s 13). This makes the administration of the charitable trust easier. It also helps protect individuals comprising the Board, because the Board assumes the role of trustee and the liabilities associated with that position, eg liability for breach of trust, or under a contract with third parties.

The protection afforded by incorporation is not absolute. If a person is involved in the management of a Board then potential liability remains. This will always be the case with trustee-formed Boards. With society-formed Boards, the constitution will often provide for an executive committee to manage the Board, and only those members forming part of the executive committee will face potential liability. For the purposes of this article the term "members" of the Board refers to each of the trustees of a trustee-formed Board and also to the people forming part of the executive committee of a society-formed Board. People not part of a society-formed Board's executive committee are not included in the term "members" because, although they comprise part of the Board, there is probably no prospect of them becoming personally liable by virtue of their status.

Potential liability may be to third parties, to the Board itself or under statute. No case law relating to Boards has been located. The authority on other body corporates, especially companies, may be applicable.

## LIABILITY TO THIRD PARTIES

### Breach of trust

The effect of s 14 is that from the moment of incorporation the obligations imposed by the constitution and the Trustee Act apply only to the Board and not to its individual members. There is therefore no potential for members becoming liable as a trustee after incorporation.

However a member of the Board who acted in breach of trust prior to incorporation will not be released from liability because of the incorporation of the Board. The Board must (like any other new trustee) make reasonable inquiries into previous trust affairs and, if a breach is discovered, take proceedings against those responsible.

### Liability of members for breach of trust by the Board

A related question is whether if the Board breaches the terms of the trust or its fiduciary duty, the members can be held liable for this. This could only occur if either:

(a) The members owe a duty directly to the potential beneficiaries of the trust; or
(b) A statutory provision allows recovery against the members for a breach of trust or duty by the Board; or
(c) The members can be secondarily liable for knowingly assisting the Board in its breach of trust or fiduciary duty.

#### *Direct duty*

By analogy with the law applying to the directors of a company trustee, the members of a Board may not owe a fiduciary duty directly to the potential beneficiaries of a trust (*Bath v Standard Land Co Ltd* [1911] 1 Ch 618).

#### *Statutory provision*

Section 60 of the Act provides (amongst other things) that the Attorney-General or a member of the public (*Morgan v Wellington City Corporation* [1975] 1 NZLR 416) may apply to the Court for an order that a trustee of a charitable trust carry out the trust according to the terms of the trust, and that any trustee be required to personally meet his or her liability for any breach of trust.

This section alters the general rule that only the Attorney-General may take action to enforce the execution of charitable trusts (*Ku-ring-gai Municipal Council v A-G* (1954) 55 SR (NSW) 65, Ford & Lee, *Principles of the Law of Trusts*, 3rd ed, para 20040). Slightly different rules apply where the issue is the validity of a charitable trust or who should "represent" the interests of a charitable trust in other proceedings.

Section 60 covers charitable trusts generally, and not just charitable trusts of which a Board acts as trustee. It is likely that the section does not include within the definition of "trustee" the individual members of a Board, even where the Board was incorporated on the application of trustees and not by the members of a society. Support for this view comes from the fact that s 23 of the Act expressly refers to individual members of a Board when intending to cover them. It would also be illogical for s 60 to extend to the members of a trustee-formed Board and not the members of a society-formed Board.

Even if this interpretation is incorrect, s 60 is likely to be regarded as a procedural provision not intended to create substantive rights. Because it is likely that members do not owe a direct duty to potential beneficiaries, even if an individual Board member could be a "trustee" within the section it is difficult to see how he or she could be compelled to "meet his [or her] liability for any breach of trust" when only the Board itself is the trustee.

### *Secondary liability*

By analogy with company law, it is arguable that the members of a Board may be secondarily liable for knowing assistance in the Board's dishonest breach of trust or fiduciary duty (Underhill & Hayton, *Law of Trusts and Trustees* (15th ed), p 428. See also the cases there cited, *Re Air Canada and M & L Travel Ltd* (1994) 108 DLR (4th) 572 and *Royal Brunei Airlines v Tan* [1995] 3 All ER 97).

A potential beneficiary of a charitable trust who seeks to have the members made secondarily liable may lack standing. As stated above, in the absence of statutory intervention only the Attorney-General can enforce a charitable trust. Charitable trusts, as trusts for a purpose, convey no *beneficial* interest to any person or conceptually certain class of persons.

A potential beneficiary under a charitable trust is unable to enforce the trust against the trustee without using s 60. If statutory assistance is needed to give standing to proceed against the trustee, then statutory assistance is probably also required to make a subsidiary claim against individual members on the basis that they are secondarily liable. There is no statutory provision which permits this.

Members are not protected from this potential secondary liability where the Attorney-General becomes involved. The Attorney-General can rely on its (non-statutory) position as the Crown's representative and protector of all charities to proceed against the individual members for knowing assistance, or knowing receipt (*Ku-ring-gai*).

### *Contract*

The Board may enter into contracts, and as a corollary is capable of being sued on any contract it enters (s 13).

Members will not by virtue of their status alone be liable for breach of any contract entered into the Board. This is a consequence of the Board's separate legal personality. However, members must ensure they do not mistakenly enter into a contract in their own name whilst intending to enter the contract on behalf of the Board. Members must also comply with the requisite formalities and obtain appropriate authorisation before entering into contracts on behalf of the Board, or else they may be liable to the other contracting party for breach of an implied warranty of authority.

By analogy with the law of companies and incorporated societies, members of a Board which breaches a contract will not be liable for the tort of inducing the breach of contract just because they control the activities of the Board, providing they act within the scope of their authority (*Said v Butt* [1920] 3 KB 497; *Henderson v Kane and the Pioneer Club* [1924] NZLR 1073).

### *Torts*

A member's duty to consider the interests of creditors when the Board is insolvent or nearly insolvent may or may not be a tortious duty. It is considered under the heading "Liability to the Board itself" because if such a duty exists it is likely to be owed to the Board and not to creditors directly.

It appears there is no New Zealand case on whether a member of a Board can be liable in tort to third parties. The position of company directors is likely to be analogous, but the law relating to director liability in tort is uncertain.

The starting point is that an individual director can be liable for torts such as negligence, defamation or deceit just like any other person. The real issue is whether this liability should be recognised when the company itself may be liable instead of, or as well as, the director for the same act.

Until recently Court of Appeal authority indicated that a director will in the usual course be "identified" with their company, and therefore will not be personally liable, unless the director assumed personal liability by their actions (*Trevor Ivory v Anderson* [1992] 2 NZLR 517). This decision has been criticised and subsequent decisions have not applied it in a consistent manner.

*Meridian Global Funds Management Asia Ltd v The Securities Commission* [1995] 2 AC 500 signals a change of emphasis. In this case the Privy Council focused on whether a director's act could be "attributed" to the company, leaving the director's personal liability to be considered separately. For further discussion on this topic see the recent articles by Watson, [1997] CSLB 149 and Campbell [1998] CSLB 34.

A full discussion of these company cases is outside the scope of this article. They do show that there is authority holding that directors of a company can be personally liable for their actions undertaken while (at least in their own eyes) they are acting on behalf of the company only.

### *Charitable Trust Boards*

It is difficult to see why members of Boards incorporated under the Act should be treated any differently to the directors of a company. Each are given powers and responsibilities associated with their position as controllers of their respective entities. Both entities may own substantial assets and engage in trading activities. The existence of both types of entity can be considered beneficial to society. The scope for a Board member to be in a situation where tortious liability arises is generally more limited, but that is no reason why liability will not exist if it would exist for a director of a company in a similar situation.

## LIABILITY TO THE BOARD

### Failure to consider creditors' interests when Board insolvent or nearly insolvent

The existence and nature of this duty is uncertain so it is considered separately from a member's other fiduciary duties. Again the law relating to directors' liability provides a valuable analogy.

### *General law in relation to companies*

Prior to the Companies Act 1993, which may have codified the law relating to director's duties (Beck & Borrowdale, *Companies & Securities Law*, 5 ed, p 56; Morison's *Company & Securities Law*, Vol 2, ch 23.2), it was probable that the directors of a company which was insolvent or nearly insolvent owed a duty to consider the interests of a creditor of the company. However this was not completely free from doubt due to the Privy Council decision of *Kuwait Asia Bank EC v National Mutual Life Nominees Ltd* [1990] 3 NZLR 513. It is likely that such a duty did exist in New Zealand, since *Kuwait Asia Bank* is inconsistent with House of Lords decisions and earlier New Zealand authority, and the Privy Council analysis was brief (*Fernyhough v Rankin Nominees Ltd* (1998) 8 NZCLC 261, see Beck [1998] CSLB 106).

That duty was probably owed to the company and not to the creditor directly (*Morison*'s, ch 24.8). However upon liquidation of the company a creditor can apply under s 301 of the Companies Act 1993 (formerly s 321 of the Companies Act 1955) to obtain an order that a past or present director pay compensation to the liquidator, if that director has misapplied or retained the company's property or been guilty of any negligence, default, or breach of duty or trust in relation to the company. This section does not create a new right of action, but merely enables a third party to enforce an existing right of action if one exists (*Grayburn v Laing* [1991] 1 NZLR 482).

### *Analogy with Boards under the Act*

Section 25(4) provides that where a Board is liquidated, the liquidation provisions of the Companies Act 1993, including s 301, apply with all necessary modifications.

The Act does not provide a statutory scheme imposing duties upon members of a Board. The general law therefore probably applies. By analogy with the case law relating to companies, it is possible that a member owes a duty to consider the interests of a creditor of the Board when the Board is insolvent or nearly insolvent. It is probable that any such duty is owed to the Board and not to the creditor directly. Therefore the creditor will not have a direct remedy against the member. However this may be of little significance when the Board is actually liquidated, as at that point s 301 of the Companies Act 1993 will be applicable (with the necessary modifications). A member who has not duly considered the interests of the creditor when the Board was nearly or actually insolvent will be in breach of duty and may then be ordered to personally contribute either to a specific creditor or (more usually) to the Board's assets subject to the liquidation. This is a significant potential liability which all members should be aware of.

## Breach of fiduciary duty

### *Fiduciary duties generally*

The term "fiduciary" describes a relationship in which one person (the fiduciary) must exercise rights and duties in good faith for the benefit of another person. Whether a fiduciary relationship exists must be determined having regard to the particular facts of the case.

### *Are members fiduciaries?*

It is likely that in many situations the members of a Board will be fiduciaries of the Board. They would therefore be liable to the Board if they breach their fiduciary duty.

It is well established that a director of a company owes fiduciary duties to his or her company (*Regal (Hastings) Ltd v Gulliver* [1942] 1 All ER 378 (HL)). The Privy Council has also accepted that an officer of an incorporated society can, depending on the scope of the responsibility, be a fiduciary (*NZ Netherlands Society v Kuys* [1973] 2 NZLR 163). Both of these situations are analogous to the position of a member of a Board but there appears to be no case law directly on the point.

There seems no reason why the scope of the members' fiduciary duty should be any different to that of a company director under the general law. For example, why should a member of a Board which diverts an investment opportunity available to the Board for his or her personal benefit be treated differently from a director of a company which does the same thing?

### *Extent of fiduciary duties*

If a fiduciary relationship exists then the member must act in good faith in the interests of the Board, exercise powers under the constitution for a proper purpose, exercise reasonable care and skill in the performance of his or her duties, and avoid any conflict of interest (*Morison*'s, ch 23 and 24).

### *Duty to act in good faith for benefit of Board*

When exercising a power (which may be only the right to vote at a Board meeting) a member must believe that the exercise of that power is in the Board's best interests.

It is submitted that the duty to act in the Board's best interests must be interpreted bearing in mind the Board's obligations under the charitable trust of which it is the trustee. Unlike a company, the reason for the Board's existence is not to benefit the Board itself (or any shareholders) but to carry out administrative and perhaps investment or business activities to further the relevant charitable purpose.

One can imagine situations where the Board's interests as a body corporate do not entirely align with the constitution of the charitable trust (eg where the trust requires the entire net income to be expended each year, this will expose the Board to a higher risk of insolvency in subsequent years). Presumably the proper execution of the charitable trust will be seen as always in the best interests of the Board.

### *Duty to exercise powers for proper purpose*

The scope for member liability for breach of this duty is limited. Its application in company law has been almost exclusively in the area of share dealings, which are not relevant to Boards. A possible example in the Board setting is where there is a schism amongst the Board members and the majority exercise a power of variation or expulsion in the constitution for personal reasons.

### *Duty of care*

It is submitted that by analogy members owe a duty of care and skill to their Board essentially the same in nature to that owed by directors to their company (prior to statutory intervention under the Companies Act 1993).

Traditionally the duty was set at a very low level, and conduct akin to gross negligence was required before it was breached. The situation now is uncertain since New Zealand Courts were heading toward a normal negligence standard, before the Privy Council in *Kuwait Asia* reaffirmed the traditional approach (*Morison*'s, ch 24.18).

Further uncertainty is created by the split decision in *Daniels v Anderson* (1995) 16 ACSR 607 (NSW(CA)). After a lengthy discussion of the authorities, it was held by the majority that the gross negligence standard was out of date. However the duty owed by the directors was considered as a common law duty (as opposed to a fiduciary duty) to take reasonable care in the performance of their office. The existence of fiduciary obligations affecting the directors did not preclude this common law duty.

The minority, Powell JA, rejected the existence of common law duty (at least in the present case) where there was already a fiduciary duty to exercise care and skill. His Honour noted that older cases referring to "negligence" did not mean negligence in the common law sense, but instead meant the care and skill required of a fiduciary in equity.

The majority did not refer to *Kuwait Asia* case. The minority briefly referred to it but distinguished it as a case in which there was "known reliance".

The result is that there is here some uncertainty about whether the duty of care is a common law duty, a fiduciary duty, or both. There is also uncertainty about the standard of care required to fulfil the duty (or duties). The Companies Act 1993 varied the standard to normal negligence for company directors. For officers of other corporate bodies the general law, whatever it may be, will still apply.

Whichever test is applicable, the breach by a member of the required standard of care in relation to the Board creates a potentially serious liability, given that many Boards are engaged in trading activities involving substantial sums.

### *To whom is the member liable?*

By analogy with other corporates, because the members' fiduciary relationship is with the Board these duties are owed only to the Board itself. A member in breach of fiduciary duty could therefore be proceeded against by the Board at any time. Proceedings could be bought against past and present members by certain other parties under s 301 Companies Act 1993 upon liquidation of the Board.

### *Can the Board consent to breach of duty?*

There is a possibility that where a majority of the members have acted in breach of a fiduciary duty owed to the Board they may join together to either grant the Board's consent to the breach or to refuse to take action against themselves. If this occurred in a society-formed Board the non-executive members or dissenting members may be able to take action against the members if the rule in *Foss v Harbottle* (1843) 2 Hare 461; 67 ER 189, can be avoided. They could also possibly obtain an injunction preventing breach of the constitution or obtain damages for breach of contract.

In all other situations the Attorney-General may be the only person who can prevent this occurring, because unlike other trusts the potential beneficiaries of a charitable trust have no ability to enforce the terms of the trust. In refusing to take action against the members, the Board itself has probably acted in breach of the charitable trust. The members will have knowingly assisted in this breach of trust by the Board, and therefore the Attorney-General will be able to take action against them in his role as protector of charities (as discussed above).

## STATUTORY LIABILITIES

### Under the Act

Members of a trust Board will be liable on summary conviction for a small fine where the Board fails to deliver to the Registrar of Incorporated Societies notice of any change in the constitution of the Board, or notice of property received by the Board on trusts not completely shown in the constitution, within one month of the change or receipt (s 23).

### Crimes Act 1961

Section 230 of the Crimes Act 1961 may also apply. This provides that every "trustee" who, with intent to defraud and in violation of his or her trust, converts any property subject to the trust commits an offence. The maximum penalty is seven years' imprisonment. Section 230(2) defines "trustees" as (amongst other things) the trustees upon an express trust created in writing (s 230(2)(a)) and "every person upon whom the duty of any such trust devolves or comes" (s 230(2)(b)). It is not clear whether the later paragraph is intended to cover only replacement trustees and delegates, or whether it is also wide enough to cover those individuals who control a body corporate trustee.

There appears to be no New Zealand case law on the effect of this provision.

## CONCLUSIONS

Incorporation under the Act provides protection for those constituting a Board because the Board is a separate legal entity from its individual members. However where those individuals are responsible for the management of the Board then their potential liability remains.

Individuals not on the executive committee of a society-formed Board usually have no management role.

Individuals on trustee-formed Boards, or on the executive committee of society-formed Boards, do have a management role. They control the Board and are in an analogous position to the officers of other corporate bodies, such as companies and incorporated societies. They may be burdened with similar responsibilities and potential liabilities.

### *Potential liabilities of members*

Members may be liable as knowing assistants to a breach of trust by the Board. It is probable that only the Attorney-General could take such action.

It is increasingly likely that members may be personally liable to third parties for negligence, and virtually every other tort, if their actions are not treated as being exclusively the actions of the Board itself.

Members may be personally liable if they fail to consider the Board's creditors when the Board is insolvent or nearing insolvency. Such liability is likely to arise only upon liquidation pursuant to s 301 Companies Act 1993.

Members may be liable to the Board if in the particular case they are a fiduciary of the Board and they breach their fiduciary duty. Possibly the Board will take action against individual members. More likely the issue will arise upon liquidation pursuant to s 301. Breach of the fiduciary duty to take the required standard of care in managing the Board's activities represents the most serious risk to members. The level of care required may be the normal negligence standard. The other fiduciary duties place restrictions on the members (eg by preventing a member usurping a Board business opportunity), but they are less likely to be an issue in the management of most Boards because of the very nature of a Board and the activities carried out by it. For this reason there is less potential for liability for breach of these fiduciary duties.

There are also limited statutory liabilities. ❑

# UPDATES TO YOUR MATERIALS

## STUDENT COMPANION

*edited by*

*Richard Scragg*

## COMMERCIAL LAW

### Duncan Webb

*Amalgamated Finance Ltd v Yeow* (High Court, Wellington, AP 323/97, 31 July 1998, Goddard and Gallen JJ)

In this case a creditor under a hire purchase arrangement wrongly repossessed a television (worth around $2500) due to a computer error. Although this was an action brought under the provisions of the Hire Purchase Act 1971 rather than the Credit (Repossession) Act 1997, which is now applicable, the provisions are substantially identical and the principles will be the same.

Entry was gained by a window. The wife of the debtor (who spoke Chinese and little English) was distressed and, believing a burglary had occurred, called the police. The debtor returned early from a business trip in Malaysia to attend to these matters. The financier refused in the first instance to return the television when the mistake was discovered. The television was returned only when a lawyer wrote to the financier.

The two member Court held that awards under a number of heads were appropriate. Special damages were awarded for the costs of obtaining a replacement television, and reinstalling the original television when returned. Full solicitors' costs were awarded for the intervention that was required to gain the return of the television.

Perhaps most interesting was upholding of the District Court's award of $10,000 general damages which included damage for distress. Arguments by the financier that the award was inappropriate as it departed from the contract principles on which such awards ought to be made were rejected.

The Court stated that:

> The Act confers a wide discretion on the Courts to grant reasonable relief on such terms as to damages as the Court in the circumstances of the case thinks fit, having regard to the conduct of the parties, the nature of the purchaser's default, and such other matters as the Court thinks proper. On the basis of that wide discretion we are unable to accept that an award of compensation is bound to be limited by the common law rules of contract whilst nevertheless acknowledging, as did the District Court Judge, that contractual principles do provide a sensible starting point for the exercise.

A punitive award of an additional $5000 was, however, overturned on the basis that under the Hire Purchase Act 1971 penalties are limited to $500 by s 48. It was also considered inappropriate to circumvent the intention of the Act by making a similar award of exemplary damages. It is, however, of note that under the Credit (Repossession) Act 1997 there is no such limit on any punitive or exemplary awards which might be made. Therefore the door is open for exemplary damages under s 13 of that Act.

## EMPLOYMENT LAW

### Graham Rossiter

*Steelink Contracting Services Ltd v Manu* (Court of Appeal, CA 54/98, 16 November 1998)

This was an appeal against an Employment Court decision which held that the employment contract contained a clause that was harsh and oppressive (s 57 Employment Contracts Act 1991) and that the respondent had been unjustifiably dismissed.

The contract included a clause which empowered the employer, a contracting company, to stand down workers in response to fluctuations in demand for work. Manu was stood down at a time when there was limited work available but not called back to work by the employer when vacancies later arose. Ultimately, the employer did not invite him back at all.

In the Employment Court, the stand down clause was set aside as harsh and oppressive. On appeal to the Court of Appeal, this finding was held to erroneous as a matter of law. The important points made by the Court were that:

(a) if at the time it was entered into, a term in an employment contract was capable of operating in a manner that was not harsh and oppressive but was also capable of being used harshly and oppressively by one party, it should be considered having regard to the fundamental obligation of each party to act towards the other fairly and in such manner as maintains the relationship of good faith and confidence;

(b) a clause would be inherently harsh and oppressive and therefore within s 57(1)(b) of the Act only where there is a realistic likelihood that it would be used in a manner that was harsh and oppressive and any such abuse by the employer could not be checked by invocation by the employee of the employer's obligation to act fairly and in good faith. In other words, might the pursuit of a personal grievance provide an adequate alternative remedy with respect to any possible harsh and oppressive exercise by an employer of a contractual power? With respect to the particular contract clause in question, it was held that the correct approach was to inquire if the provision could operate fairly and reasonably in its context, as properly constructed with regard to the duty of fair treatment rather than by examining how it might, in theory, operate to the disadvantage of employees by its use as a substitute for redundancy.

Notwithstanding the foregoing, the Court upheld the finding of the Employment Court that the employee had been unjustifiably dismissed. That was a decision open to the lower Court even on the basis that the initial suspension of Manu was an exercise of a valid contractual right to stand down. It had been inconsistent with the employer's duty to act fairly and in good faith for it to decide unjustifiably not to offer work to Manu which later became available and to leave him as a nominal employee to whom there was no genuine intention to offer further work.

It might be noted that s 135 of the Act provides for a right of appeal to the Court of Appeal from a decision of the Employment Court said to be "erroneous in point of law" other than a decision on the construction of an employment contract. Ostensibly, the qualification to this provision might be seen as creating a problem for the appellant in this case but this limitation on appeal rights does not extend to questions of principle going beyond the particular terms of a contract or to the approach in law adopted by the Employment Court relating to the interpretation of a contract.

## ADMINISTRATIVE LAW

### Hamish Hancock

### Bias

*In re Pinochet* (House of Lords, reasons 15 January 1999, Lords Browne-Wilkinson, Goff, Nolan, Hope and Hutton)

The House of Lords on 25 November 1998 by a majority of three (including Lord Hoffmann) to two held that Senator Pinochet was not entitled to immunity from extradition proceedings by the Spanish Government for alleged crimes against humanity.

On 10 December 1998 Pinochet petitioned to set aside that decision, claiming that Lord Hoffmann's links with Amnesty International were such as to give the appearance of possible public bias.

A freshly constituted bench set aside the earlier decision. It said everyone whom the prosecutor seeks to bring to justice was entitled to the protection of the law, however grave the offences with which he is being prosecuted. Pinochet was entitled to the judgment of an impartial and independent tribunal.

The connections between Lord Hoffmann and Amnesty International were of such character, in view of their duration and proximity, as to disqualify him. As the chairman and a director of Amnesty International Charity Ltd he could not be seen to be impartial.

There was no suggestion that Lord Hoffmann was actually biased – he had no financial or pecuniary interest in the outcome – but his relationship with Amnesty International was such that he was, in effect, acting as a Judge in his own cause. The House of Lords therefore concluded that his failure to disclose these connections led inevitably to the conclusion that the decision to which he was a party must be set aside.

### Inquiry reports

*Royal Australasian College of Surgeons v Phipps* (Court of Appeal, CA 70/98, 30 November 1998)

RACS appealed unsuccessfully from the High Court decision that it had jurisdiction to hear P's application for judicial review of a report of reviewers (surgeons) prepared by RACS for Healthcare Otago, P's employing hospital, and (largely) successfully from the substantive judicial review decision quashing that report.

The Court of Appeal held the report was reviewable. The duty to adhere to the rules of natural justice in carrying out the review were implied in RACS's constitution which gave it the power to contract with P's employer Healthcare Otago to undertake the review. The Courts have made it clear that in appropriate situations, even although there may be no statutory power of decision or the power may in significant measure be contractual, they are willing to review the exercise of the power including review for breaches of natural justice. The Court of Appeal held the report should not be quashed. The parts affected by the errors could be severed. The reviewers had been careful to consider each allegation separately and the Court saw no danger of errors in one area infecting other parts of the report. A declaration should issue instead that in certain limited instances P had not been given proper notice of allegations and a proper opportunity to reply. A memorandum of corrections acknowledged to be required by RACS was attached.

*Peters v Sir Ronald Davison* (Court of Appeal, CA 72/98, 17 November 1998)

The Court of Appeal in allowing Mr Peters' appeal against the striking out of his proceedings against the Winebox Commission in the High Court, said that certain alleged errors of law (relating to the construction of the Magnum transaction and obligations of disclosure under s 301 of the Income Tax Act 1976) in the conclusion of the Commission's Report are arguable. If established they were sufficiently material, going to the substance of a significant part of the report to warrant a declaration. That conclusion is reinforced by the fact that the resulting answers to competency issues in respect of both the Inland Revenue Department and Serious Fraud Office were directly related to and helped form the basis of the stringent criticisms of Mr Peters with the consequential effect on his reputation.

An alleged error of law made by a commission of inquiry in its report which materially affects a matter of substance relating to a finding on one of its terms of reference is in general reviewable. The reason for exercising that power of review is the stronger if that error damages the reputation of any person directly concerned in the inquiry.

### Interim relief

*R v Ministry of Agriculture Fisheries and Food, ex p Monsanto plc* [1998] 4 All ER 321 (Queen's Bench Division: Rose LJ and Bell J)

The applicant company developed and marketed a herbicide. The herbicide's patent and data protection expired and then became available for use by other generic manufacturers. It applied for interim relief to suspend the operation of the approval granted to company Y pending judicial proceedings.

The Court held that the general principles governing the grant of interim relief applied in relation to judicial review proceedings. That, however, had to be in the context of the public law questions raised in such proceedings, which were, in general, intended to provide swift relief against abuse of executive power; they were neither intended for, nor well suited to, inhibiting commercial activity, particularly over an indefinite, substantial period of time. In the present case, there was clearly a serious issue to be tried. Whilst the applicant had no sustainable claim for relief based on inadequacy of damages, it was doubtful whether damages would provide an adequate remedy for company Y. With regard to the balance of convenience, there was a strong presumption against making an order for interim relief where it would have the effect of restricting free competition. It was in the public interest that, until set aside, the decision of a public body should be respected. The purpose of the licensing provisions was to serve the public interest, rather than to protect private commercial interest. These were catered for by patent and data protection. Accordingly, on an undertaking by company Y limiting sales of its product, the application would be dismissed.

## LAND LAW

### Julia Pedley

### Clarification of Covenant to Repair

*Weatherhead v Deka New Zealand Ltd* (High Court, CP 8/97, 7 October 1998, Baragwanath J)

The construction of repair clauses in leases where an inherent defect in the property is alleged was considered by the High Court. This was an appeal by Weatherhead, as lessors, from an arbitration which held that the proposed repairs did not fall within the lessee's obligation to repair. The repairing covenant in question stated:

> The Lessee doth hereby further covenant with the Lessor as follows:
>
> (c) That it will during the said term well and sufficiently repair maintain amend cleanse and keep the demised premises with the appurtenances and all fixtures and things thereto belonging (including the glass windows thereof) or which at any time during the term shall be erected and made by the Lessor in good and substantial repair and condition when where and so often as need shall be having regard to the condition thereof at the commencement of the term reasonable wear and tear only excepted.

Part of the leased premises was known as "the restaurant building" which adjoined the remainder of the leased premises. Deterioration in the structure of that portion known as "the restaurant building" had occurred. Accordingly, the local District Council, acting pursuant to s 624 Local Government Act 1974, served notice on the lessors requiring either demolition or works to be undertaken to ensure the interim security and ultimate strengthening of the portion of the building known as "the restaurant". A dispute arose between the lessors and Deka as lessee, over who was liable to carry out the necessary repairs. At arbitration it was held that the defects constituted inherent defects. It was also clear that the cost of the repairs would approach the cost of replacing the existing building with a new building. The arbitrators considered that the restaurant should be treated as a unit in its own right, that is, separate from the remainder of the premises to which it was attached and concluded that such substantial works did not fall within the ambit of the lessee's repair obligation contained in the lease. The lessors appealed.

On appeal, the essence of the appellants' argument was that the entire building should be taken into account so that the extent of the repairs when set against the entire premises would not result in a renewal or replacement of substantially the whole subject matter of the lease.

In dismissing the appeal Baragwanath J acknowledged the existence of English authorities but emphasised that due to "such encrustation of ancient authority", before adopting a particular decision, consideration should be given as to whether it suits current New Zealand conditions. After canvassing relevant authorities Baragwanath J considered that certain principles may be drawn from the variety of factors to be considered when interpreting repair covenants in leases. In summary these were:

- Freedom of contract;
- Presumption of intention to put into repair. That is, a covenant to keep in good repair will be construed as meaning to put the premises into repair;
- The concept of repair is to make good damage;
- If the work requires renewal of substantially the whole subject matter of the lease then this goes beyond repair;
- It is a question of fact and degree whether the obligation relates to a particular building or a part of it.

Applying those principles to the facts before him, His Honour first turned his attention to the appellants' contention that the restaurant building should be treated as subsumed within the remainder of the leased premises, with the consequent result that the repairs to the restaurant building would not then amount to renewal or replacement of substantially the whole premises of the demise. His Honour was unwilling to accept this argument, finding that the appellants had failed to demonstrate that the arbitrators had erred in treating the restaurant as a distinct entity. As a consequence, in terms of the obligation to repair, His Honour found that the required works amounted to renewal and not repair. On that basis it was held that the lessee was not responsible for the necessary works.

### Sale or Partition under s 140 Property Law Act 1952

*Wallace v Cottingham* (Court of Appeal, CA 107/97, 1 December 1998)

Where a co-owner with a 50 per cent or greater interest in land makes an application to the Court under s 140(1) Property Law Act 1952, requesting the Court to direct a sale of the land rather than an order for partition, the statute requires the Court to direct a sale unless the Court sees good reason to the contrary. *Wallace v Cottingham* is notable for the Court of Appeal's analysis of what constitutes good reason to the contrary.

The case involved an appeal made by Wallace and Molloy, two of three tenants in common from a decision of the High Court granting summary judgment to Cottingham, the third joint tenant, for the land to be sold. Cottingham, who owned a one half undivided share of the property had brought proceedings in the High Court seeking an order for sale of the jointly held property pursuant to s 140. Before the High Court it was clear that Wallace and Molloy, who each owned a quarter undivided share, desired partition whereas Cottingham, who had expressed an intention for purchasing the entire property, sought an order for sale. Finding that there was no good reason not to direct a sale, Anderson J made an order for sale. In doing so, however, His Honour directed that the order for sale should lie in Court until further order of the Court with liberty for any party to further apply. In so doing, His Honour expressed his view that the financial interests of the parties might be best served by making an inquiry as to subdivision. Subsequently, Wallace and Molloy made an application for a resource consent to subdivide the property. Although initially unsuccessful in their application, on appeal to the Environment Court on 17 March 1998 they succeeded in obtaining consent to subdivide. Meanwhile, various Court proceedings had continued between the parties relating to directions for sale, followed by a successful application for a stay and a further application seeking an extension of the stay.

Before the Court of Appeal it was argued for the appellants that subsequent to Anderson J's judgment, as a result of the granting of resource consent for subdivision, there now was in accordance with s 140 of the Property Law Act 1952, "good reason to the contrary" in favour of partition. In support of this, counsel for the appellants made reference to valuation evidence which if accepted, pointed to partition rather than sale as being more favourable financially to the parties. Reference was also made to the potentially lower costs associated with a subdivision as compared with the costs associated with a sale of the property.

Counsel for the respondent, however, submitted that a more speedy and less complicated resolution to the dispute would be achieved by a sale which would have the effect of severing the relationship between the parties in a more satisfactory way than would be achieved by partition. In this regard counsel argued strenuously that a speedy resolution is a principal object of s 140 and that only in exceptional circumstances should the Court exercise its discretion in favour of partition instead of sale. Moreover, it was submitted that even where partition was either physically possible or may result in better financial terms for the parties, this was not enough to constitute exceptional circumstances sufficient to outweigh the primary objective of s 140.

This argument was rejected by the Court of Appeal on the basis that a party seeking partition rather than an order for sale, has the burden of showing that there is good reason for a partition rather than a sale. There is no requirement for exceptional circumstances to be shown.

Allowing the appeal and setting aside the summary judgment, judgment of the Court of Appeal was delivered by Blanchard J who stated that, "If the interests of one party are promoted to a significant extent by partition and the interests of the other party are not seriously prejudiced, good reason may have been shown". The Court concluded that on the evidence there had been a demonstration of "good reason amply sufficient to resist the respondents' summary judgment application".

The Court made the point that although the decision of Anderson J was the right decision for the circumstances at the time made, since that time the circumstances had substantially changed. This substantial change in circumstances had largely resulted from the appellants seeking and being granted resource consent for subdivision, an opportunity made possible by the "great wisdom" of Anderson J in his suspension of the order for sale, thereby affording the appellants the opportunity of pursuing the question of subdivision.

### Caveatable Interests

*Waitikiri Links Ltd v Windsor Golf Club Inc* (Court of Appeal, CA 132/95, 9 November 1998)

Divergent views have long prevailed over whether a caveatable interest must be an interest that is capable of being registered under the Land Transfer Act 1952, or whether the term extends to any equitable interest in land, registrable or not. Discussion can be found at para 2.145 of Butterworths *Land Law in New Zealand*.

So, it is timely that the Court of Appeal (sitting with five Judges) in *Waitikiri Links Ltd v Windsor Golf Club Inc* has expressed an opinion (albeit a provisional one) on this matter. Although the Court considered that there was "plainly no present significance in the questions sought to be argued", and, refusing the appellant's application for leave to argue, dismissed the appeal, there is significance in the opinion of the Court on the issue of caveatability.

Application was made to the Court by Waitikiri Links Ltd for leave to argue the question of whether Windsor Golf Club Inc was entitled to the protection of a caveat registered against Waitikiri's title. Windsor's lease was in the form of a deed, and as a consequence was not in registrable form. The terms of the lease were silent on the matter of registration. Waitikiri's argument was that where an unregistered deed of lease contains no provision as to registration, then it is to be concluded that the parties must have agreed that the lessee was not to have the right to call for a registrable document. As a result, the appellant maintained that for an interest to be caveatable it must be one which is capable of being made into a legal interest by registration.

The Court of Appeal referred to *Wellington City Corporation v Public Trustee* [1921] NZLR 1086, which presented a "substantial obstacle" to the appellant's argument opposing caveatability. The Court then went on to express its provisional opinion that on the issue of caveatability it preferred "as a matter of policy the broad view", as expressed in para 2.145 of Butterworths *Land Law in New Zealand*.

While acknowledging that the Court's view on the issue of caveatability is nothing more than obiter and was clearly expressed as only a "provisional opinion", this should not be permitted to detract from the fact that this was the unanimous view of a five-Judge Court of Appeal. As such, the decision is noteworthy for its guidance on the issue of the caveatability of equitable interests, with a clear judicial expression of support being shown for the broad view that any equitable interest in land is sufficient to support a caveat, even where the caveator does not have a registrable interest.

### The Conveyancers Bill

The Conveyancers Bill, a Member's Bill of Labour MP Phil Goff, was introduced into Parliament on 23 October 1997. The purpose of the Bill was to promote greater competition with respect to conveyancing and real estate sales, while ensuring that adequate consumer safeguards are maintained. The Bill provides for the establishment of a new licensed occupational group of conveyancers who will have the same right to undertake conveyancing work as members of the legal profession.

The Justice and Law Reform Select Committee, who had been considering the Bill since November 1997, issued an interim report on 17 November 1998 to inform the House of Representatives as to its progress.

Although the select committee was advised that early in 1999 the government intends to introduce legislation for the deregulation of conveyancing, it elected to issue the interim report on the principle that having considered the issues raised in submissions, such a report would be of value to the House and the public. Despite the wide range of views expressed about the deregulation of the conveyancing industry, the select committee expressed general support for promoting competition.

The select committee did recommend some changes to the Bill, which, in summary, are as follows:

- notwithstanding the fact that the Bill had implied that a company may be licensed as a conveyancer, it is not appropriate for limited liability companies to register as conveyancers although an exception should be made for trustee corporations;
- in response to concerns that legislative guidelines be set out regarding the academic and professional qualifications required for a registered conveyancer, the Conveyancers Board should establish the nature of the qualifications required. In addition, it should be a function of the Board to prescribe a code of conduct for registered conveyancers;
- in response to concerns expressed about when conveyancers should be entitled to practise on their own account, (given that solicitors cannot practise on their own account in New Zealand without having three years' experience), there should be no restriction on conveyancers being able to practise on their own account as soon as they are qualified;
- persons acting under supervision should not be able to act as a conveyancer;
- with regard to conveyancers arranging for indemnity insurance cover, this insurance obligation should be limited to those practising on their own account;
- in support of the proposal made by the Bill to allow solicitors to undertake the work of real estate agents, (the effect of this would be to reverse the Court of Appeal decision in *Lewis v Real Estate Institute of New Zealand* [1995] 3 NZLR 385), the select committee recommended that any person working under the supervision of a solicitor who chooses to sell real estate should not be required to be a certified salesperson;
- to amend either the Bill or the Law Practitioners Act 1982 to provide that a solicitor acting as a real estate agent must disclose any personal interest in the property which they have been commissioned to sell;
- to amend either the Bill or the Law Practitioners Act 1982 to provide that a solicitor may not act as both the vendor's real estate agent and as the purchaser's solicitor. Similarly, a conveyancer should not act for both the vendor and purchaser in the same transaction;
- conveyancers should be allowed to sell real estate and persons acting under the supervision of conveyancers who also sell real estate should not be required to be certified salespersons;
- the Real Estate Agents Act 1976 and the Law Practitioners Act 1982 should be comprehensively reviewed. ❑

# WORLD TRADE BULLETIN

*Gavin McFarlane, Titmuss Sainer Dechert, London*

***traces increasing activity on the world trade front***

## WTO DISPUTES

The dispute resolution procedure of the World Trade Organisation has been put to the test by the intensity of feeling generated by the banana confrontation between the European Union on the one hand, and America and its allies. A reconvened panel will adjudicate on (a) whether the EU has altered its importation regime sufficiently to have complied with the rulings of the WTO appellate body; and (b) if the EU is found not to have complied, what compensation must be paid to the states which are parties to the complaint lodged against it. What is unclear is whether the United States has put on hold pending these deliberations its threat to impose a 100 per cent duty on the importation into America of a wide range of exports from Europe.

There is no doubt that the matter has been taken to the brink by the protagonists. The conduct of both sides has been severely damaging to the standing and authority of the new WTO forum as it struggles to assert itself after only four years of existence. A fundamental principle of the rule of law is that the authority of a legal jurisdiction is accepted by those subject to it. This is etched deeply into the constitutions and legal systems of both sides to the banana dispute. A lawyer acting for a party to a dispute in the ordinary Courts would be horrified if the client was issuing press releases questioning the ability of the pool of Judges from which the adjudicating panels were drawn, the quality of the Judges and their familiarity with the relevant jurisprudence, or even whether the Court in question was likely to survive for very much longer. Yet this is precisely the kind of inflammatory comment which has been coming out of both Washington and Brussels over recent months. What makes the situation worse is that these comments have been made on both sides by officials at the highest levels; in some cases, they have been made by very senior people who have had long experience as lawyers in their own countries, and who should know better than to do this.

The reality is that even when the banana dispute is finally concluded, there will be an increasing number of disputes in the pipeline for the WTO to deal with. Many of these will be between the USA and the EU, who are the most frequent patrons of the new system. First in line will be the beef hormone dispute, where the time limit for complying with the WTO ruling runs out in May. But the EU has already indicated that it is seeking to avoid compliance with the ruling by producing scientific evidence to back the European stance on the hormone problems. However, this new science will certainly not be available by the time that the deadline falls. Unless a solution is found for this impasse, the debate on hormones will be still more abrasive than the banana episode. The US beef industry is claiming that it loses millions of dollars annually in consequence of the Europeans' attitude. Behind this event looms a spat over genetically modified organisms (GMOs), which will make beef hormones and bananas seem like childish tiffs. There are fundamental differences of approach to the GMO question between Europe and the United States, both at the political and popular levels. America, with its vaster areas of land under cultivation has a much lower density of population than Western Europe. Americans generally perceive agriculture and the land on which its crops are grown as part of the nation's industrial infrastructure – how many dollars will it produce per acre? Attitudes in Western Europe tend more to reflect concerns about the environment, and diminishing amounts of open space. Not for nothing does the Common Agricultural Policy appear to support large numbers of hobby farmers! But already a regulatory committee of the European Union has rejected four separate applications for approval for the sale or growth of GMOs. The most recent failures were two varieties of genetically modified cotton produced by the American company Monsanto. Although the Commission has given approval to some GMOs in the past, in the face of hardening public attitudes among the electorates of European countries it seems that the EU will be forced into a rigid policing of the sale and growth of GMOs which can only antagonise the owners of rights in these products. So watch out for even more spectacular litigation at the WTO.

Some of the comments which have been made during the ongoing banana dispute have gone so far as to suggest that the very existence of the dispute settlement forum and even the WTO itself may be under threat. Should the misbehaviour of officials on both sides actually bring about the demise of the WTO, then the prospect for harmony in the next century are not propitious. It is probable that at the end of the day, the WTO forum will have survived the banana dispute. But the fledgling body will have been quite severely wounded by the experience. One problem for it which will not go away is that international trade disputes are almost always about some form of trade barrier which has been erected between nations. When a dispute is referred to the WTO Court, it is almost impossible to fudge the issue. The trade barrier is either legal in WTO terms, or it is illegal, and the forum has to find for one side or the other. It does not enjoy the luxury which was said to have been exercised by the European Court of Justice when that body was struggling to establish itself in its early years, of giving fairly bland judgments which were calculated not to inflame public opinion in the member states.

But steps need to be taken urgently to protect the position of the WTO's dispute settlement body. The most practical advance would be to introduce the sub judice principle into the procedures contained in the understanding accepted by member states. This would make it clear to senior trade representatives of states which had brought a dispute to the

WTO for adjudication that anyone who attempted to denigrate the members of the panels sitting to try the matter or their function would be in contempt of Court

## FINANCIAL SERVICES

The agreements concluded at Marrakesh in 1994 contained an agreement on financial services, and the thrust of the WTO will be towards reducing barriers to trade in financial services as a matter of priority. There is no doubt that both in the EU and the US there is considerable interest in this project, for the economies of both regions are moving strongly towards the provision of services, particularly in the financial sectors, and away from manufacturing. It is therefore a matter of crucial importance to them that when they seek to export financial services to other countries, they should not have to overcome obstacles to entry in the form of trade barriers. This is particularly true in the case of underdeveloped countries, which may be unwilling to allow foreign financial services in, either because it will result in an outflow of currency, or because they wish to protect domestic business trying to establish itself in the same area. The EU is particularly pleased with the progress which the WTO administration is making on financial services, as it proceeds to add a series of protocols to the General Agreement on Trade in Services (GATS). It is no surprise therefore that the Council of the EU has followed the opinions of both the European Parliament and the Commission's Economic and Social Committee, and authorised the approval of the fifth protocol to GATS. These commitments are largely in respect of the insurance industry, and are to be found in the Council decision L20/38 (OJ 27 January 1999).

## (FAIRLY) UPBEAT IN GENEVA

The WTO Annual Report for 1998 has just been published, and is remarkably upbeat, despite the financial crisis which has afflicted various parts of the world. It stresses the vital role which the international trading system has to play in dealing with the problems which face the world's economy, but puts the blame for these problems on the financial system. It argues that the WTO provides a valuable bulwark against protectionist pressures which could emerge from the significant alterations in trade flow which might be a consequence of the crisis. It is undoubtedly true that a further liberalisation of trade in financial services was achieved in these negotiations which were completed at the end of 1997. The report claims that there have been no major trade policy reversals in consequence of the worsening economic conditions in the world, even in those countries most directly affected by the financial crisis. This does tend to ignore developments such as those which have been put in place in Malaysia, although there has recently been some indication of relaxation there. It is a fact that despite the financial turmoil, significant trade liberalisation packages continue to have been put in place in Asia, and most favoured nation tariff reductions have continued elsewhere around the globe. But the WTO does note that particularly in Latin America, there has been some increase in the scrutiny of imports; it also records significantly that trading frictions between major trading partners appear also to be on the rise. The WTO concludes that these are often localised, and confined to long-standing issues. Certainly the majority of disputes this column is tracking between the EU and the United States involve sores which have been festering for a long time, but as they are the major protagonists in the WTO forum, they could scarcely be described as local players there. There may be a growing sensitivity about market access as global economic activity weakens. The WTO also thinks that there may be some slowdown in regional economic integration. Certainly in the world steel market, falling prices and excess capacity is beginning to produce friction in the form of new anti-dumping activity. Although the WTO and most developed countries would wish to avoid this scenario, the mood is likely to be rather negative in any trade negotiations which are scheduled to take place over the next few months. Hopefully these will have cleared by the new round of GATT negotiations which are expected to begin at the start of the new millennium.

## ANCHOR BUTTER IN THE UK

An appeal to the VAT Duty Tribunal, *Anchor Foods Ltd*, LON/97/7054, C00073 concerned the New Zealand butter quota under regulation 1600/95 amended by regulation 1170/96. These were enacted by the Commission in implementation of the Agreement on Agriculture in the Uruguay Round of GATT. By this, New Zealand is entitled to an annual quota of 76,667 tonnes of butter at a duty of 86.88 ecu per 100 kg, compared with 260.70 ecu otherwise payable, on condition that the butter is "Butter, at least six weeks old, of a fat content by weight of not less than 80 per cent but less than 82 per cent, manufactured directly from milk or cream". This must fall within CN Code 0405 10 11 or 19, which sub-divisions do not include recombined butter falling under 04 05 10 30.

Customs ruled that test consignments of Ammix (salted creamery butter) and Spreadable Butter imported into the UK as natural butter within 04 05 10 19 were recombined butter and not manufactured directly from milk or cream. This decision had been based on the manufacturing process. The EU Court of Auditors had discovered that some imports at the reduced rate of levy had undergone a process known as "fractionation". The Director-General for Agriculture of the Commission of the EU stated that in principle there were two ways of making butter, the traditional churning process, and a process leading to recombined butter. "The New Zealand butter under consideration here is not manufactured directly from milk or cream, but produced from anhydrous milk fat with recombination with an aqueous phase of milk non-fat solids." The Commissioner additionally stated that butter produced by the Ammix process also fell outside the quota requirements.

The Tribunal recorded that when the accession of the UK to the EEC had been negotiated a major objective of the UK had been the safeguarding of access for New Zealand butter to the UK market. The appellant submitted that butter was manufactured directly from milk or cream if the raw material input was milk or cream, and butter was the product which resulted from the application of an uninterrupted process to that raw material. Customs claimed that in order to qualify for the preferential quota the consignments had to satisfy the "manufactured directly" criteria and must be natural as opposed to recombined butter.

The tribunal concluded that on a normal use of language the butter in the consignments was manufactured directly from milk. It did not consider it appropriate, when considering whether a continuous manufacturing process is direct, to examine the state of the materials in the middle of that process. It found that the introduction of a sub-division of the CN Code for recombined butter was inconsistent with the quota criteria of the Marrakesh Agreement, because if the butter is manufactured directly from milk or cream it is not recombined. The appeal was allowed. ❑

# DISCOVERY OF CO-ACCUSED CONVICTIONS

*Russell Lawn, an Auckland practitioner*

*advises on handling "cut-throat" defences*

The expansion of the defence's right to pre-trial disclosure of witness convictions has gone down an incremental route culminating in the Court of Appeal's procedure outlined in *Wilson v Police* [1992] 2 NZLR 533 at 542 (see Lawn "Discovery of Crown Witness Convictions" [1992] NZLJ 216 for a discussion of cases leading up to *Wilson*). The facts of that case related to an application by a defendant for particulars of convictions of witnesses proposed to be called by the Police and dealt with the facts on that basis. In the common situation where a co-accused becomes a de facto prosecution witness in the context of the colourful "cut throat defence" the reasons for applying for the particulars of prosecution witness convictions is no less poignant as regards co-accused convictions. Indeed, when one considers the first paragraph of the *Wilson* procedure it appears equally apposite, being:

> (i) Before all defended trials, whether on indictment or summary, the prosecution should, as a general rule, notify the defence of any conviction known to the prosecution of a proposed witness whose credibility is likely to be in issue, if that conviction could reasonably be seen to affect credibility. For this purpose knowledge must of course extend to every such conviction of which the prosecution is in fact aware as a result of a computer check or otherwise. For trials on indictment a prosecuting authority entitled to access to the computer should make such check as a matter of course. For summary trials the authority should make such a check if requested by the defence and may in any event make one if it sees fit. If the authority is in doubt whether a conviction should be disclosed, counsel's advice should be taken.

Cooke P confirmed that this was part of a broad guideline and was not the last word on every aspect. This dicta appears particularly prescient with reference to the co-accused position and the writer submits the co-accused position falls equally within the guidelines thus requiring the police or prosecuting authority to disclose co-accused convictions to counsel acting for another accused upon the request of that accused counsel to the prosecutor. In this situation the same test of "... any conviction known to the prosecution of a proposed witness whose credibility is likely to be an issue, if that conviction could reasonably be seen to effect credibility ..." applies just as much to a co-accused giving evidence as it does to a prosecution witness giving evidence. In that situation the proviso at p 543 of *Wilson* that the presiding Judge may impose conditions upon the disclosure of convictions to ensure a fair trial, not inconsistent with the effective conduct of the defence, such as prohibiting an accused or his counsel from disclosing a conviction to any other person, or making use of it otherwise and for the purposes of trial appear compelling where a co-accused is having such private information put into the hands of another accused person. This also appears compelling because providing information as to any convictions does not guarantee that they will be available to an accused person for use at trial, but merely forewarns that accused to be ready to use convictions disclosed prior to trial at trial if the circumstances appear favourable and necessary. This approach it is submitted is confirmed by s 6 Principle 11(e)(i) and (iv) of the Privacy Act 1993 in making the disclosure sought in accordance with the application to a Court, the provision provides:

> An agency that holds personal information shall not disclose the information to a person or body or agency unless the agency believes, on reasonable grounds –
>
> (e) That non-compliance is necessary –
>
> (i) To avoid prejudice to the maintenance of the law mainly public agency, including prevention, detection, investigation, prosecution, and punishment of offences or;
>
> (iv) For the conduct of proceedings before any court or [tribunal] (being proceedings that have been commenced or are reasonably in contemplation).

Would a Court read down "proposed witness" in the test to refer only to a proposed prosecution witness. This would be unfortunate when the requirement for fairness means "any possible" witness which includes a co-accused. For a Court to adopt any other approach when a co-accused almost invariably does not give evidence in a preliminary hearing prior to trial thereby eliminating any ability to examine a co-accused under s 12 of the Evidence Act 1908 would result in no mechanism being available for discovery of convictions under the record of a co-accused. A Court would not read down the test with that as the result.

Having acquired particulars of a co-accused's convictions can then the accused use them? Section 5(4) (b) of the Evidence Act 1908 reserves to the Court a discretion as to whether to admit evidence of an accused's character. Where a co-accused gives evidence at the trial of a co-accused person attacking the character of the accused, which in short would be readily achieved by testifying that the accused was guilty of the offence charged rather than the co-accused, then unless the convictions were significantly different or out of context from the nature of the charge before the Court it would appear at first sight to be wrong for the Court to

***continued on p 84***

# THE OFFICIAL ASSIGNEE AND MATRIMONIAL PROPERTY

*Anthony Johnson, Martelli McKegg Wells & Cormack, Auckland*

*Explains the interface of insolvency and family law*

## EXECUTING MATRIMONIAL PROPERTY AGREEMENTS

The decision in *re Beals* (High Court, Palmerston North, B 121/95, 17 February 1998, unreported) raises the issue as to what property vests in the Official Assignee upon adjudication.

*Briefcase* provides the following description of *re Beals*:

> Company Law: unsuccessful application, under s 86 Insolvency Act 1967, by bankrupt for reversal of OA decision to execute matrimonial property agreement. Settlement made with estranged wife under s 21 Matrimonial Property Act 1976; attempt by OA to avoid the litigation wife may have brought; Held, OA met obligations to deal fairly with B's assets, to protect creditors and not to incur unnecessary expenses; not unreasonable to conclude settlement; to set aside decision would provide no practical benefit.

The description adequately summarises the decision. The argument, as it was put to Gendall J, was whether the OA's decision was reasonable. Her Honour found in the circumstances that the decision was reasonable. What was not argued was whether the OA actually had authority to settle a bankrupt's claim under the Matrimonial Property Act ("MPA"). Case law indicates the OA may not in fact have that right.

Section 20(1)(b) of the MPA provides as follows:

> Subject to subs (2) of this section, and except as otherwise expressly provided in this Act, all property that would have passed to the Official Assignee on or following the bankruptcy of the spouse if this Act had not been passed (and no other property) shall so pass to the Official Assignee.

The exception in subs (2) relates to the protected interest in the matrimonial home. It can for the moment be put to one side.

In essence, s 20(1)(b) provides that the OA's rights are to be determined as if the MPA had not been passed. The OA does not acquire the bankrupt's rights under the MPA. Refer *Tonkin v Tonkin* (High Court, Napier, CP 55/85, 21 November 1986) where McGechan J stated:

> The obvious legislative intention is that with only limited exceptions the Matrimonial Property Act does not affect the normal position prevailing consequent upon bankruptcy and the normal expectation of creditors in that event.

*Tonkin* was applied in the Family Court decision of *Aitkenhead* (Family Court, Auckland, FA 1547/89, 23 July 1993, unreported). In that case, Judge MacCormick (at p 6 of his decision) stated:

> To my mind the position is then quite clear. It has been held on several occasions both in this Court and in the High Court that the provisions of s 42 of the Insolvency Act 1967, when considered in conjunction with the provisions of s 20 of the Matrimonial Property Act 1976, have the effect of vesting in the Official Assignee those assets of the bankrupt which existed on normal property principles at the time of bankruptcy whether under the general law or by any Matrimonial Property Act orders which may have been made prior to but not after adjudication.

He continued (also at p 6):

> I do not now consider that Mrs Aitkenhead has any further claim under the Matrimonial Property Act against the Official Assignee. That is for the reason already cited and on the authority of the three cases cited to me by counsel for the Official Assignee being *Tonkin v Tonkin*; *Official Assignee v Davidson* (1987) 4 FRNZ 6 and *Wilcocks v Wilcocks* (Family Court, Dargaville, FP 2/84, 19 March 1993).

Finally, the Judge concluded (at p 7):

> I do not consider that the correspondence of 28 August 1989 makes any difference, because I fail to see how that correspondence can give the Court a jurisdiction to entertain Mrs Aitkenhead's claim under the Matrimonial Property Act which it no longer effectively has by statute. ...[T]o the extent that Mrs Aitkenhead may have any further claim to the moneys held in the trust account it must lie under the general law and not pursuant to the provisions of the Matrimonial Property Act 1976. I conclude that the Family Court has no jurisdiction to determine the matter under the provisions of the Matrimonial Property Act 1976.

Applying these authorities, it can be argued that the OA has no power to bring a claim under the MPA against the non-bankrupt spouse. Equally, the non-bankrupt spouse has no power to bring a claim under the MPA against the OA of his or her partner's estate. In executing a matrimonial property agreement, the OA is purporting to deal with the rights of the bankrupt under the MPA. But if those rights have not vested in him, can he legitimately take this step? The answer must be that he cannot. What then is the actual position as between the OA, the bankrupt, the non-bankrupt spouse, and property that was owned by the spouses, either separately or jointly, as at the date of adjudication?

### THE NON-BANKRUPT SPOUSE

As set out in *Tonkin*, the non-bankrupt spouse cannot bring a claim against the OA, on the basis that he or she has not received the entitlement that he or she would have received under the MPA. Any entitlement that was available under the MPA (except for the protected interest in the matrimonial home) is extinguished upon adjudication. See *Davidson v Davidson* (1988) 4 NZFLR 513, 523:

> At the time of the commencement of the bankruptcy she did not have any interest in that property and it passed to the Official Assignee in bankruptcy. The position is covered in the decision of McGechan J in *Tonkin v Tonkin* (CP 55/86, Napier Registry, Judgment 21 November 1986, unreported). I adopt with respect what was said by the Judge in that judgment that although the wife may have had a claim to the business as being matrimonial property prior to the husband's bankruptcy she did not have a proprietary interest in the property. It ceased to be matrimonial property on the commencement of bankruptcy and any claim that she had in respect of it disappeared.

It is open to the non-bankrupt spouse to make a claim, based not on MPA principles, but on normal proprietary and equitable principles. Such a claim is effectively a claim for a proprietary interest in assets owned jointly or separately by the other spouse. See *Prowse* [1994] 1 NZLR 225 and *Hooker* (High Court, Hamilton, AP 84/91, 28 May 1993). The claim can be made in the Family Court under ss 23 and 25 of the MPA, but not based on the principles of the MPA. See *Hooker* (at p 46):

> For the reason given I remit the case to the Family Court to enable the learned Judge to determine in accordance with the principles of common law and equity, the legal and equitable rights of the bankrupt spouse in property which passed to the Official Assignee at the commencement of the bankruptcy.

The non-bankrupt spouse can also rely on s 20(2) of the MPA, which concerns the protected interest in the matrimonial home. At the present time, that protection extends to $83,000 or half the equity in the home, whichever is the lesser. That protection exists, whether or not the non-bankrupt spouse is registered as an owner of the property.

### THE BANKRUPT

Pursuant to s 42 of the Insolvency Act 1967, all property owned by a bankrupt at the date of adjudication, or vesting in him or her between that date and the date of discharge, vests with the OA.

By virtue of s 20 MPA, the bankrupt's claim under the MPA does not vest in the Official Assignee. However, there is a catch. Although the OA cannot bring a claim, should the bankrupt bring a claim during the course of his or her bankruptcy, and that claim is successful, any property received will fall into the bankrupt's estate. Section 24 sets out time constraints for the bringing of proceedings under the MPA. Subsection 2 gives the Court discretion to extend the time limit. A prudent bankrupt would not bring a claim under the MPA during the bankruptcy. It is uncertain whether after discharge a Court would exercise its discretion and allow the discharged bankrupt to bring such a claim.

### THE OFFICIAL ASSIGNEE

Relevant to the OA are:

1. what property passes to the OA (s 20(1)(b));
2. the setting aside of agreements that defeat the OA (s 47).

As noted above, all property owned, either legally or equitably, by the bankrupt at the date of adjudication vests in the OA. Further, all property that the bankrupt acquires during the course of the bankruptcy likewise vests in the OA. Examples of such property include:

- all property in the sole legal ownership of the bankrupt, subject only to a non-bankrupt spouse's equitable claims or other equitable claims;
- half of all property legally jointly owned, subject to any equitable claims;
- any property at all to which the bankrupt has an equitable claim.

In respect of legal ownership, the OA's task is relatively straightforward. All such assets can be realised, subject only to the equitable claims of the non-bankrupt spouse and others.

The OA has a much more difficult task in establishing an equitable claim to property not registered in the bankrupt's name. In respect of the Family Home there will be a general assumption of an equitable interest held by a bankrupt not registered on the title. In relation to other equitable claims, whilst acknowledging the duties imposed upon a bankrupt pursuant to s 60 of the Insolvency Act 1967, the reality is that obtaining evidence from a bankrupt in relation to such claims, will not be a straightforward process.

Finally, there is the issue of matrimonial property agreements. In *Official Assignee v Neill* [1995] NZFLR 297, the Court of Appeal summarised the evidentiary requirements to be met by an OA endeavouring to set aside a matrimonial property agreement made under the MPA. The Court determined that an agreement would be void against the OA (and any other creditor) if the OA could show that, at the time of the agreement, any disposition made pursuant to the agreement defeated creditors. If the agreement took place within two years before adjudication, the OA did not have to prove an intention to defeat creditors. If the adjudication was more than two years after the agreement, the OA has to prove both that the effect of the agreement was to defeat creditors and that the party(s) intended to defeat those creditors.

The important issue for the OA is what constitutes "defeating of creditors". In *Neill* the agreement transferred to the non-bankrupt spouse the matrimonial home and other items. The bankrupt received shares which at the date of adjudication were worthless. If the OA was to be successful in his claim, he needed to show to the Court that, as at the date of the agreement, the shares were worthless. The OA was unable to provide such evidence. The agreement was therefore not set aside.

The important facts that the OA has to consider are therefore:

- the date of the agreement;
- what assets were transferred;
- evidence as to the value of those assets at the date of the transfer;
- whether the non-bankrupt spouse received more pursuant to the agreement than she would otherwise have been entitled to receive under the MPA.

The OA's usual presumption is that the proper entitlement under the MPA is an equal share in the value of assets. For the sake of completeness, however, the provisions of s 13 and s 14 of the MPA, which refer to occasions where the presumption of equal sharing is not applicable, should be noted.

## REFORM

The MPA has been in place for 22 years. The original policy behind the exclusion of the OA from any interest under the MPA was the legislature's wish to establish and maintain the special status of matrimonial property rights.

Parliament is now moving towards the recognition of non-marital partner property rights. If there is no legal ownership, those rights are presently recognised in equity. However, being equitable rights they, unlike rights under the MPA, can be the subject of a claim by the OA. If there is to be parity between the positions of marital partners and non-marital partners, this inconsistency must be addressed.

Section 20(1) excludes from a bankrupts' estate, property that is held by the bankrupt solely pursuant to matrimonial property principles. The first option is for this exclusion to be extended to de-facto property held solely on a similar basis.

Alternatively, and arguably more sensibly, the present exclusion should be removed. Effectively, Parliament is indicating that the policy underlying the special status of matrimonial property rights does not now exist. If that is correct, then all partners, be they marital, de facto, or business, should be treated equally under the insolvency laws. As partners share in the economic benefits of a partnership, so they should face the adversity of insolvency should that situation arise. Upon adjudication should not the starting point be that all property interests of the bankrupt come into the bankrupts' estate?

A side effect of removing the s 20(1) exclusion would be that, as with any other partnership, the OA could enter into agreements to settle matrimonial property claims. This effectively brings the discussion back to *R E Beals*. As with that decision, the sole consideration in assessing the OA's actions would then be whether he has met his obligation under s 86 of the Insolvency Act 1967 not to act unreasonably. ❑

---

***continued from p 81***

exercise the discretion against the accused to put the co-accused's character in issue through evidence of previous convictions for criminal conduct. Indeed, that is the position in the United Kingdom with regard to s 1(f)(iii) of the Evidence Act 1898 which provides:

> A person charged in Court as a witness in pursuance of this Act shall not be asked, and if asked shall not be required to answer, any question tending to show that he has committed, or being convicted of, or being charged with any offence other than that wherewith he is then charged, or is of bad character, unless –
>
> (ii) He has given evidence against any other person charged in the same proceedings.

In England the Court has no discretion to refuse an accused the right to cross-examine a co-accused where he is subject to such an attack by the co-accused. Lord Donovan, in *Murdoch v Taylor* [1965] AC 574 at 592, put it:

> On the question of discretion I agree with the Court of Appeal that a Trial Judge has no discretion whether to allow an accused person to be cross-examined as to his past criminal offences once he has given evidence against his co-accused.

And he stated earlier:

> "Evidence against" means evidence which supports the prosecution's case in a material respect or which undermines the defence of the co-accused.

The justification stated by Lord Morris at p 584 being:

> If an accused person, when giving evidence for the defence, has given evidence against any other person charged with the same offence, the question arises whether the latter needs the permission of the Court before putting to the witness any question of the kind noted in para 1(f) .... In my judgment he must have liberty to defend himself by such legitimate means as he thinks wise to employ. This does not, however, mean the Judge has no function to discharge. In the first place it will be for him to rule as a matter of law whether a witness has or has not given evidence against any other person charged with the same offence. ... In the second place, it is always for a Judge to rule in regard to the relevance of any evidence and therefore in regard to the propriety of any question which it is desired to ask ....

In New Zealand the Court of Appeal in *R v Clark* [1953] NZLR 823 at 830 stated that:

> We think that, although the matter is, in New Zealand, one of discretion the limits prescribed by English statutory position so evolved as a compromise should, in general, be observed in the exercise of the discretion.

The Court further observed that there may still be cases outside the limits set by the English Act in which the discretion should be exercised in favour of allowing cross-examination. Thus, applying the *Murdoch* approach in New Zealand would effectively remove any real discretion to deny use of a conviction in evidence once discovered under *Wilson* which could reasonably affect credibility on the part of a co-accused. The writer's respectful opinion then is that all defence counsel should include a request for co-accused convictions from the Police and/or prosecutor as part of their standard pretrial procedure. If that be so, then whether the co-accused is to receive a fair trial within the meaning of s 25 of the New Zealand Bill of Rights Act 1990 is a question of equal weight to that of the accused's right to a fair trial. It would appear that granting severance of a trial to avoid injustice to that co-accused may well be the remedy, but of course the co-accused may not be a willing prosecution witness in the event of being asked to appear as a prosecution witness against the accused, the co-accused not then being on own trial. That being so, striking the right balance between accused, co-accused and the prosecution interest will continue to be a demanding question for the Court when ruling on questions of law which entitle an accused person using a co-accused convictions in evidence in the course of a criminal trial, the mere granting of discovery of co-accused convictions to an accused in the writer's experience has a highly inhibiting affect on co-accuseds' willingness to give evidence in their own defence and thus face the possibility of their convictions being put in evidence. The ready availability of co-accused convictions does not affect the "fairness discretion" addressed in *Murdoch*, and "fairness" under s 25 of the Bill of Rights Act gives no additional substantive guide to the Court in the exercise of its discretion whether to grant an accused person the right to cross-examine co-accused persons on their criminal convictions. ❑

# MORE TINKERING WITH THEFT AND FRAUD

*Frank Quin, an Auckland lawyer*

## *reviews* R v Wilkinson

The recent decision of the Court of Appeal in *R v Wilkinson* (CA 122/98; 13 October 1998) saw a clash of late 20th century technology – electronic banking – and late 19th century criminal law – the crime of obtaining by false pretences in s 246(2) of the Crimes Act 1961. There proved to be no contest. In upholding the appeal against conviction, a full Bench held that electronically recorded bank credits are not "capable of being stolen" and, thereby, of being obtained by false pretences. The Law Commission has responded by proposing an urgent amendment to s 246(2), making use of language lifted directly from s 229A of the Crimes Act.

In this commentary it will be asserted, first, that although the decision was right the Court of Appeal has unnecessarily imposed a questionable, and confusing, judicial gloss on statutory language of considerable antiquity. Secondly, that the Law Commission's proposed response to *Wilkinson* is misdirected as a matter of substantive law and, in its use of s 229A, unsatisfactory as a matter of law reform policy.

### The decision in *Wilkinson*

*Wilkinson* concerned appeals against conviction on a number of counts of obtaining by false pretences, under the "second limb" of this crime contained in s 246(2) of the Crimes Act. The appellant was a principal of a business which imported and distributed heavy machinery. The Crown's case was that by various false representations in relation to inventory, he had induced finance companies to extend accommodation to the business. The various counts alleged the obtaining of specific sums of money but the evidence was that the accommodation had been provided by electronic funds transfers from the financiers' bank accounts to the bank account operated by the appellant's business.

### The "movability" issue

Under s 246(2), it is an offence to obtain, with intent to defraud by means of a false pretence, possession of or title to "anything capable of being stolen", or by such means to cause any such thing to be delivered to another person. The appellant's case on appeal was that he had not obtained anything capable of being stolen. Inevitably, the Court of Appeal found that these words fall to be construed by s 217 of the Act, which reads as follows:

> 217. **Things capable of being stolen** Every inanimate thing whatsoever, and every thing growing out of the earth, which is the property of any person, and either is or may be made movable, is capable of being stolen as soon as it becomes movable, although it is made movable in order to steal it.

Both the majority (in a judgment delivered by Henry J) and Thomas J in his separate judgment held that whatever had been obtained by the appellant from the finance companies could not come within s 217 because it unequivocally requires that to be capable of being stolen a thing must be movable. In other words, it must be *tangible*. Electronic funds transfers undoubtedly involve proprietary interests which may be violated but, being choses in action, they are intangibles and cannot satisfy the requirement of movability.

### The "ownership" issue

To this point the decision is unexceptional. The prosecution was misconceived and the appeal should have been disposed of on this point alone. But the majority had already upheld the appeal on another ground. This was that the appellant already owned the thing obtained.

In this regard, the majority held that, where a lender advances a loan, that which is "obtained" by the borrower is not something owned by the lender. Whilst the lender uses its own property, namely the indebtedness of its bank as represented by a credit balance in the lender's bank account, in law the funds transfer discharges that chose (or reduces it pro tanto) and creates a new chose, being a debt owed to the borrower by its bank following the crediting of the borrower's account. There is thus no transfer of a thing owned by the lender and, accordingly, obtained by the borrower. In so holding, the majority directly applied the analysis undertaken by the House of Lords in *R v Preddy* [1996] AC 815 (and the subject of commentary by the writer at [1996] NZLJ 459).

In the view of Thomas J, the House of Lords in *Preddy* had been "inhibited by undue regard to ... technicalities of the transfer process". He preferred to recognise "the substance of the transaction; the money began as the property of the lender and finished up as the property of the fraudulent [borrower]". On that basis, and save only for the intangible nature of the thing obtained, Thomas J would have upheld the convictions.

### The judicial gloss

As already noted, it was unnecessary for the Court of Appeal in *Wilkinson* to go into this issue at all. The appeal was properly, and sufficiently, disposed of on the movability point. By contrast, in *Preddy* it was critical to decide who owned the relevant proprietary interests generated or affected by an electronic funds transfer, because the English crime of obtaining property by deception expressly requires that it be property "belonging to another". But there is no such express ingredient in s 246(2). So, to make the House of Lords analysis of an electronic funds transfer directly applicable to the facts in *Wilkinson*, the majority ruled that the further requirement in s 217, namely that the thing stolen be "the property of any person", means in law the property of any person *other than the accused.* No prior authority was cited for this construction (with which Thomas J implicitly agreed, whilst dissenting on the legal effect of the funds transfer).

The majority justified this judicial gloss on the footing that s 246(2), to which s 217 applies:

> is concerned only with property which is owned by another who has been fraudulently dispossessed of it. A person cannot fraudulently obtain, any more than steal, what is his or her own property in which no other person has a special interest.

It might be observed that, if some "other person has a special interest", the question is very much begged as to what was meant by the reference to the accused's "own property". The majority did not dwell on this point and was similarly untroubled by any conceptual difficulty when later returning to the issue:

> [The Crown] submitted that *Preddy* was distinguishable because s 246 did not require the property (thing) to belong to another. As has already been demonstrated, except in limited circumstances which are not relevant here, that cannot be right. The thing must be capable of being stolen, and s 217 requires that it must be the property of (ie owned by) a person. The person sensibly must be a person other than the offender.

So it seems the Court of Appeal was saying that the statutory words "which is the property of any person" in s 217 are to be read as meaning something like the following:

> which is the property of any person [other than the accused, except for cases where the accused is the owner but some other person also has a special interest in the thing, in which case the person who has the property in the thing may include the accused].

With respect, the better view is surely that the requirement in s 217 that a thing be "the property of any person" was intended to be, and should be, indifferent to the identity of the proprietor and, in particular, should *not* exclude the accused. The original purpose of this "ownership" requirement, reflecting the common law, was undoubtedly to prevent liability for theft (and by extension, false pretences) arising in the case of abandoned property or things found in nature, such as wild animals. This requirement has its origins in an age when many forms of theft were capital crimes so that it is understandable that the capacity for ownership at law should not have simply been taken for granted.

But with theft as defined in s 220, the question whether an accused has a proprietary interest in the subject matter, and if so the significance of that interest, is addressed in other ingredients of the crime. Thus, the taking or conversion must be "fraudulently and without colour of right" and, in its primary form, theft requires an intent to deprive the proprietor or person having a "special property or interest" permanently of that interest. It is these ingredients which are relevant to the issue whether the accused is liable for violation of another person's proprietary interest. At least as regards theft under s 220, it is unnecessary to have some judicial gloss on the words "property of any person" in s 217 because the policy concern raised by the majority in *Wilkinson* – that a person should not be liable for stealing his own property – is addressed in other parts of the statutory offence.

Of course the offence of obtaining by false pretences under s 246(2) is differently worded and, relevantly, does not require an absence of "colour of right" or the intention to deprive another of a proprietary interest. Arguably, the Court of Appeal's construction of the words "property of any person" prevents a possible injustice and is permissible for that reason. But quite apart from the lack of any authority for such construction, it suggests that s 217 is to be read and applied differently depending on whether it is theft or false pretences being charged. This is at the least unsatisfactory.

***The Court of Appeal need not have gone into the ownership issue at all and it has done so in generalities which are likely to cause confusion and uncertainty in future cases***

Moreover, it is quite conceivable that a legal owner of a chattel may take action which ought to be an offence under s 246(2). With respect, the majority was surely on suspect ground in construing s 246(2) as applying only to the obtaining of a thing "which is owned by another" who is thereby "fraudulently dispossessed of it". In terms, s 246(2) applies either to the obtaining of physical possession of the thing, regardless of whether ownership is obtained, or to the obtaining of a proprietary interest, regardless of whether possession is also obtained. So that, for example, s 246(2) should apply to a person who pledges a chattel as security for a loan and then deceives the pledgee into returning possession or transferring it to a third party. Or to a trustee who dupes beneficiaries into agreeing to a sale of trust assets either to the trustee or a third party in return for some bogus consideration.

The Court of Appeal in *Wilkinson* has unnecessarily added further complexity to what is already a difficult area of the criminal law. It need not have gone into the ownership issue at all and it has done so in generalities which are likely to cause confusion and uncertainty in future cases of theft or false pretences where an accused can assert a proprietary interest in the subject matter of the charge.

## The Law Commission's response

In its report to the Minister of Justice on the implications of *Wilkinson*, the Law Commission identified the need for "urgent attention" to what was thought to be a "yawning gap" in New Zealand's criminal law. Namely, that the dishonest obtaining of bank loans by means of electronic funds transfer was beyond the reach of the law. And the Commission saw the problem extending to other electronic transactions, such as the wrongful use of personal identification numbers to access telephone bank accounts.

The Commission's proposal is that s 246(2) should be amended by the insertion of a further category of things which can be the subject of the crime of obtaining by false pretences. Using terminology lifted directly from s 229A of the Act, there would be liability where the false pretence secures "any other privilege, benefit, pecuniary advantage or valuable consideration". The crime under s 246(2) would thus no longer be limited to tangible, and therefore movable, things. This legislative response to *Wilkinson* would go further than the English Law Commission's response to *Preddy*, which saw insertion into the Theft Act 1968 of the new crime of "obtaining a money transfer by deception". In its report, the New Zealand commission saw "no advantage in confining the reform to money and banking". Better to "employ the general and all-embracing terminology already used in s 229A".

If past experience is any guide, the Law Commission's proposal will be adopted with minimal public scrutiny. It will be doubtless be justified as plugging a gap in the criminal law relating to the now commonplace use of electronic funds transfer in commerce and otherwise as being a useful adjunct to s 229A. The small amendment is thus likely to be seen as uncontroversial and, perhaps more to the point, politically attractive as deflecting any wider reform of the law with its attendant cost.

***Neither is there any novelty in electronic funds transfer, this technology having been employed in banking and commerce since the invention of the telegraph last century!***

### Objections to the Law Commission's proposal

There are however two particular objections to the Law Commission's proposed response to *Wilkinson*. The first is that it is misdirected as a matter of substantive law, as indeed was the Crown's offence selection. The second is its use of terminology drawn from, and thus further validation and entrenchment of, s 229A of the Crimes Act: so-called "fraudulent use of a document". As the writer asserted at [1996] NZLJ 330, this section is creating perverse law in relation to criminal liability in New Zealand.

### Misdirection of the proposed response to *Wilkinson*

Undoubtedly, *Wilkinson* highlights a particular limitation of New Zealand's law of theft and fraud. But it cannot be said that the decision unearths some hitherto unrecognised gap in the law since the confinement of ss 220 and 246(2) to tangible chattels was deliberate and has long been recognised. Following the common law, they are crimes which protect ownership of things in possession rather than things in action.

Neither is there any novelty in electronic funds transfer, this technology having been employed in banking and commerce since the invention of the telegraph last century! What is of course "modern" is the use of electronic media for storage and manipulation of the transmitted data, in place of paper ledgers and books of account. So the better view of *Wilkinson* is its reflection of a lack of any general reform in New Zealand of a criminal law first enacted over a century ago (by the Criminal Code Act 1893) which in concept and language remains tied to 19th century views of personal property and technology.

In *Wilkinson*, the focus was exclusively on the crime of obtaining by false pretences under subs (2) of s 246. However subs (1) of this section contains an entirely separate form of the crime, namely to induce a person, by means of a false pretence, to "execute, make, accept, *etc* ... any valuable security ...".

Recall that the conduct of the appellant in *Wilkinson* was aimed at obtaining loans in circumstances where, but for the false pretence, the accommodation would not have been extended. This objective could have been achieved by inducing the finance company to write cheques payable to the appellant's business. This would have come squarely within the crime in s 246(1) since the definition of the term "valuable security" in s 2 of the Crimes Act expressly includes "any negotiable instrument, bill of exchange, cheque, or promissory note".

Perhaps the Crown saw a difficulty with the "valuable security" ingredient in the case of an electronic, and therefore "paperless", funds transfer. But it is arguable that this ingredient can indeed be satisfied in the case of an electronic funds transfer. The definition of "valuable security" is said to *include* any *document* evidencing title to "*any property of any kind whatever*", from which two observations can be extracted. First, the definition is not in terms exhaustive and could thus, within well settled principles of interpretation, be applied to media not otherwise coming within the word "document" as meaning a piece of paper. Secondly, and relevantly in the present context, s 246(1) is manifestly not confined in application to documents evidencing title to tangible things. On the contrary, in the express extension of "valuable security" to negotiable instruments and cheques, the offence is particularly relevant to funds transfers.

But perhaps the more pertinent observation is that, if the *Wilkinson* decision must lead to a "sticking plaster" legislative response, the focus should be the crime of obtaining by false pretences as defined in s 246(1) rather than the quite separate offence in subs (2). For as noted, it is the crime in subs (1) which already accommodates the fraudulent procurement of funds transfer, albeit without any express acknowledgment of late 20th century technology.

Moreover, under s 246(1) there is no apparent need to identify the owner of the valuable security. In particular, the wording of this crime avoids the question whether an electronic funds transfer involves a *transfer* of existing property or the creation of a new chose in action, being the issue which divided the Court of Appeal in *Wilkinson*.

So on the one hand it can be argued that there need be no specific legislative response to *Wilkinson* at all: the prosecution was misconceived and should have been brought under s 246(1). On the other hand, any doubt thrown up by the decision should properly be addressed by the simple expedient of amending the definition of "valuable security" as used in the Crimes Act to expressly incorporate electronic entries in bank accounts, the justification being that electronic media within a bank computer performs the same function as cheques and other paper-based acknowledgments of debt.

### The extension of s 229A

There is a further, and policy based, objection to the Law Commission's proposal, in as much as it will employ terminology lifted directly from s 229A of the Crimes Act. This section, enacted by the Crimes Amendment Act 1973 to address a quite specific situation, has effectively become a general crime of dishonesty in New Zealand. It is nowadays the "crime of choice" for the Serious Fraud Office and agencies prosecuting so-called benefit fraud. But in its use of language which, but for the requirement of "intent to defraud", describes perfectly legitimate conduct, the section is creating perversity in the application of a criminal law which at its core is supposed to criminalise violations of proprietary interests.

There is in the continuing use of s 229A in place of the traditional crimes of theft and fraud the risk of compromising a general review of the existing law, if and when that might occur, which is anchored soundly in the rules of the civil law of property. For surely it is the protection of civil law rights which should be the backdrop for any criminal law. But s 229A is producing decisions at trial and on appeal which feature scant, if any, regard to the historical development of our law of theft and fraud as involving violations of proprietary interests and which turn instead on the views of individual Judges and juries of what is, or is not, "dishonest".

The majority in *Wilkinson* concluded its decision by observing that, whereas the convictions for false pretences could not stand, "the evidence would appear to support charges under s 229A in respect of these transactions". This sentiment echoes the Court of Appeal's decision in *R v Butcher* (CA 59/97; 30 July 1997). There, convictions under s 222 (theft "by failing to account") having been overturned, Blanchard J observed that "It appears to all the members of this Court that there were before the jury all the factual elements for charges under s 229A". Such now overt enthusiasm for the use of s 229A may be compared with an earlier successful appeal against conviction under s 222, in *R v Norris* (1993) 11 CRNZ 56, where the Court of Appeal opted to "make no comment as to whether or not charges under any other sections of the Crimes Act 1961 could have been preferred".

The fact is that s 229A is so worded that it can be applied to *any* fact situation where a document of some kind features in the allegedly dishonest conduct. The cases on the section have demonstrated, first, that human conduct of any complexity will invariably involve the use of some document and thus the potential for an application of s 229A and, secondly, that the document's capacity to generate "benefit" for the accused will rarely be a triable issue.

Indeed, the Courts have long since lost sight of the original rationale for s 229A – the perceived inadequacy of the existing penalties for theft and wrongful use of "value-bearing" documents such as airline tickets and credit cards. It is quite apparent that the promoters of s 229A, whilst concerned that the range of documents falling within these characteristics should not be unduly confined, never envisaged its use as an omnibus crime of dishonesty. Yet so far has the use of the section moved from its original purpose that it is now routinely applied to any form of written communication. Examples include invoices (*R v Firth* [1998] 1 NZLR 513), internal office memoranda (*R v Chapman* (1997) 14 CRNZ 664) and letters to prospective investors in a ship salvage (*R v Baxter* [1998] 3 NZLR 144).

Moreover, in *Firth* the Court of Appeal emphatically rejected the proposition that the expression "intent to defraud" in s 229A requires an intent to deprive another person of some proprietary interest or indeed of any right or entitlement. "Intent to defraud" was held to mean the same as "fraudulently", the essence of both being "dishonesty". But there has been no cohesive attempt in New Zealand to grapple with the issues raised by the differing approaches which can be taken to the meaning of the word "dishonest". In particular, whether it is to be assessed subjectively or objectively and whether it involves questions of law, for determination by the Judge, or purely a question of fact to be left to the assessment, and disposition, of individual juries. Liberated from any connection with a violation of proprietary interests, the notion of dishonesty is of unlimited application.

## CONCLUSION

If the prevailing view is that our criminal law should indeed have such a sweeping crime of dishonesty, worded so widely as to gather up any conceivable conduct without being troubled by "technicalities", then s 229A's assumption of that role can only be applauded. Indeed, one would go further and unshackle the section from the need to have a document at all! And one could only approve the extension of its utility into other crimes of theft and fraud, as envisaged by the Law Commission with its proposed amendment to s 246(2).

But if it is thought that a fundamental requirement for a criminal law should be certainty – at least to a reasonable degree – as to what is or is not criminal conduct, then s 229A is repugnant. By the same token, so also is the Law Commission's proposed extension of s 229A into the crime of obtaining by false pretences. The Commission's attraction to "general and all-embracing terminology" was interpreted by the media (*New Zealand Herald*, 22 December 1998) as the proposition that "It was better to be vague than specific in case more gaps were discovered." Whatever the desirable attributes of a criminal law, vagueness is surely not one of them.

There are doubtless strong arguments for and against the competing policy approaches. But in New Zealand, in contrast to the lengthy law reform process which in England preceded the Theft Act 1968, there has never been a debate on which approach should be taken. Rather, we have opted for the "sweeping" approach very much by default and, it must be said, by virtue of the uncritical enthusiasm of our prosecutors and Judges for s 229A.

*Wilkinson* does not expose some gap in the law which must be closed up. It is merely one illustration, of many which could be instanced, of the fact that our law remains tied to concepts of ownership and proprietary interests developed by the common law and codified in the 19th century.

This is not to say that there are not elements of reform in the Crimes Act 1961 and its predecessors. In particular, s 222 of the Act – transposed verbatim from the Criminal Code Act 1893 – was undoubtedly intended to be a crime of theft of purely equitable proprietary interests, for that reason unrecognised and unprotected by the common law's perception of ownership as reposing, actually or constructively, in possession of a thing in specie. But regrettably our Courts have failed, by and large, to recognise the scope of the reform achieved by that section and in consequence the jurisprudence on s 222 has become mired in complexity. And as the recent cases of *Norris, Firth* and *Butcher* have illustrated, the inherent discipline required of prosecutors and Courts in having to apply civil law rules of property and contract to the criminal law of theft and fraud can today be avoided by the expedient of using s 229A.

The time has surely come for a general law reform initiative. The Law Commission's proposed response to *Wilkinson* is unsatisfactory. More can reasonably and must be demanded of our law reformers. ❑