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Reforming the Incorporated Societies Act 1908

The New Zealand Law Society (Law Society) welcomes the opportunity to comment on the Law Commission's issues paper, *Reforming the Incorporated Societies Act 1908*, Issues Paper 24, June 2011 (Issues Paper).

Introductory comments

New Zealand has pioneered many legal reforms over the years, and at an early stage of its legislative history legislated for the incorporation of community organisations. However, the Incorporated Societies Act 1908 and Charitable Trusts Act 1957 are now seriously out-of-date and no longer provide an adequate and robust modern statutory framework for incorporated societies and charitable trusts. New Zealand has lagged well behind other similar jurisdictions, particularly the Australian States and Canadian Provinces. The Law Society therefore supports the Commission's conclusion that the Act is overdue for reform, and generally supports most of the reforms scoped in the Issues Paper. The Law Society is also supportive of the proposed reforms covering other legislation including the Charitable Trusts Act 1957 and legislation dealing with the agricultural and pastoral societies and industrial and provident societies.

The Law Society notes that the range of entities covered by the Incorporated Societies Act, Charitable Trusts Act and similar legislation is considerable, and that a major challenge in drafting any new legislation will be to modernise the legislation while making it adaptable to the different types of entities. Some of the challenges include:

1. The distinction between the small neighbourhood or special interest group organisation entirely run by volunteers with minimal assets and income, and large organisations with thousands of members, millions of dollars in assets, corporate-style incomes and expenditure, experienced governance teams and professional management, possibly with many organisational layers and a national presence. A "one size fits all" approach to new legislation needs to be flexible enough not to impose huge burdens on small entities, yet establish regimes appropriate to corporate-style organisations.
2. Appreciating that most local community organisations, whether societies or trusts, and whatever interests they cater for (recreational, cultural, social, religious, and charitable), rely almost entirely on grass-roots volunteers whose qualifications, experience and skills vary considerably.

3. Considerable confusion is created for the majority of community organisations that rely on volunteers for much of their governance and administration, by having to interact with multiple government agencies. For instance, a small charitable entity may have to deal with the Registrar of Incorporated Societies, the Charities Commission and the Inland Revenue Department, and then (depending on its activities) possibly the Department of Internal Affairs, local authorities, SPARC, and others. A ‘users’ perspective is required, and establishing one central agency for at least the core registration and regular reporting requirements and advice would be a major advance.

Achieving a workable compromise is likely to be a significant undertaking.

Chapter 1 – Introduction

Q1: Do you agree that a review of the legal structure for incorporation of non-profits, and the requirements on those running such societies, would be a useful step in strengthening the non-profit sector?

Yes, because the not-for-profit sector is well-documented as contributing significantly to the social, cultural, sporting, and religious health of the community, as well as making a surprisingly important contribution to the economy. Lawyers advising community organisations and members of such organisations (not only those in governance or management) find little guidance in or assistance from the current legislation and the often inadequate constitutions of those organisations. The consequent difficulties in dealing with problems that arise disrupt the activities of those organisations, and cause stress and unnecessary cost.

The Law Society agrees with the Commission’s view in paragraph 1.12 of the Issues Paper:

“Bodies that are incorporated under a new Incorporated Societies Act should ... share the following characteristics, facilitated by the legislation:

- they should be established for a public purpose or for the (non-financial) benefit of their members;
- they should be private and independent;
- they should be self-governing; and
- in general, their income and profits should not be channelled to members, trustees or anybody else except as reasonable compensation for services rendered.”

Q2: Is the current limitation of liability sufficient?

The Law Society believes that those responsible for causing loss to community organisations should be responsible if they fail to comply with the constitutions of those organisations, but otherwise considers the current limitation of liability adequate. The approach in Part 3 of the British Columbia Society Act 1996 would be worth close consideration.

Q3: Do you agree that there should only be one statute for the incorporation of not-for-profits in New Zealand? If not, why not?

The Law Society favours having one statute for the incorporation of not-for-profits in New Zealand. Confusion is caused by the present multiplicity of statutes (and government agencies) dealing with community societies – including the Incorporated Societies Act, Charitable Trusts

Act, Agricultural and Pastoral Societies Act 1908 (to say nothing of the many special statutes enacted to assist individual A & P Societies), and also the Industrial and Provident Societies Act 1908 – to which one might add (at least) the Friendly Societies and Credit Unions Act 1982.

The Law Society therefore favours bringing all relevant legislative provisions dealing with the incorporation and governance of not-for-profit entities into one statute. That would not only make it easier to find the law, but would also establish consistent principles and processes (especially for registration, monitoring and compliance) applicable to all not-for-profit organisations in New Zealand.

The Commission suggests in paragraph 1.23 of the Issues Paper that registration under the Charitable Trusts Act does not grant a trust limited liability. Whilst not necessarily agreeing with that proposition, the Law Society considers it should be made explicit. The Law Society commends to the Commission for consideration, sections 4 and 5 of the British Columbia Society Act 1996 which deal clearly with the consequences of incorporation (but see the discussion on Question 29 below):

Effect of incorporation

- 4 (1) From the date of the certificate of incorporation, the members of a society are members of a corporation
- (a) with the name contained in the certificate,
 - (b) having perpetual succession,
 - (c) with the right to a seal, and
 - (d) with the powers and capacity of a natural person of full capacity as may be required to pursue its purposes.
- (2) The powers referred to in subsection (1) include but are not limited to the following powers:
- (a) to buy, sell, exchange, develop and mortgage property;
 - (b) to borrow money and give security for it and secure or purchase money obligations;
 - (c) to issue negotiable instruments;
 - (d) to receive and make gifts;
 - (e) to enter contracts and leases;
 - (f) to employ persons;
 - (g) to belong to other societies or associations, whether or not incorporated, with similar purposes or purposes beneficial to the society.
- (3) A society may sue and be sued, contract and be contracted with, in its corporate name.
- (4) A certificate issued by the president, secretary or a director of a society stating that the intended exercise by the society of a power described in the certificate is for a purpose of the society stated or summarized in the certificate is, as between the person to whom the certificate is issued and any other person, including the society, and past, present and future members or creditors of the society, conclusive proof of the truth of the matters set out in the certificate if the person to whom the certificate is issued acts on it in good faith and within a reasonable time.

Liability of members

- 5 A member of a society is not, in the member's individual capacity, liable for a debt or liability of the society.

There are two associated issues to consider:

- While it seems clear that one statute for the incorporation of societies (of whatever nature) is desirable, there remains the possibility of confusion if charitable trusts are covered in the same statute.
- Most charities find it very confusing having to deal with both the Registrar of Incorporated Societies and the Charities Commission, and the opportunity should be taken to facilitate processes by having all documents filed with just one agency.

Q4: Do you think that for some purposes it might be advisable to divide societies between members' benefit and public benefit societies? If so, in what circumstances?

The Law Society considers this question to be closely related to Questions 9 and 41. The Law Society believes such a division involves recognising that there are distinctions between societies that exist purely for the benefit of members (for instance, a bridge or social club, or a society representing the interests of an occupation or profession) and those that exist purely for the public benefit (for instance, an environmental group, a women's refuge, or citizens' advice bureau). However, the Law Society notes that the legal nature of an entity and the nature of an entity's purposes should not be confused or conflated – two different sets of issues arise.

The Law Society believes, however, that difficulties may (and do) arise in organisations where the distinctions between the two types of entity are blurred. For instance, there exist many societies that have both charitable ("public benefit") purposes but also provide benefits to members (discussed in cases such as *Royal Choral Society v Commissioners of Inland Revenue* [1943] 2 All ER 101 at 104–105 (CA) per Lord Greene MR quoted in *Canterbury Orchestra Trust v Smitham* [1978] 1 NZLR 787 at 807 (CA)). This is particularly true of those from which members derive personal support, recreation and enjoyment (for instance, many religious, sporting and cultural organisations), and the courts accept private benefits to members if the purpose is integral to a charitable public purpose: *Presbyterian Church of New Zealand Beneficiary Fund v Commissioner of Inland Revenue* [1994] 3 NZLR 363; and *Hester v Commissioner of Inland Revenue* [2005] 2 NZLR 172 (CA).

The Law Society generally agrees with paragraph 1.35 of the Issues Paper which recognises that

“... even if there is one statute, there may need to be different rules in that statute to take account of different requirements of different kinds of organisations. Canadian provinces like Saskatchewan, and Ontario, as well as the federal Canadian government, have divided incorporations which are for members' benefit primarily on the one hand from those that are for public benefit or charitable purpose on the other. It may be appropriate to have different rules in some circumstances depending on the status of a society, as we later discuss in relation to distribution of assets on the dissolution of the society.”

The Law Society is not aware of any real difficulties arising from the requirement that members of societies incorporated under the Incorporated Societies Act 1908 should not derive pecuniary benefit from their membership, although it would be useful and helpful to have the meaning of that made more explicit. However, despite the inherent problems of definition already referred to in respect of societies that have both charitable ("public benefit") purposes but also provide benefits to members, the Law Society considers any distinction between members' benefit and public benefit societies might be better based on the difference between members' benefit and charitable (public benefit) entities registered with the Charities Commission.

If the Incorporated Societies Act 1908 and Charitable Trusts Act 1957 are to be incorporated into the same statute, provision also needs to be made for the incorporation of charitable trusts. However, the question can be asked whether there is any reason in principle why there should not be a members' benefit trust as well as the common charitable (public benefit) trust. For the purposes of providing for the incorporation of members' benefit and charitable (public benefit) entities, the distinctions between the types of entity may be irrelevant.

The Law Society also notes the present awkward description of societies and trusts in the Charitable Trusts Act 1957 as "Boards" and suggests a more generic and understandable word such as "organisation" or "entity."

Q5: Should Agricultural and Pastoral Societies be incorporated under the new statute?

As noted above (Question 3), the Law Society favours having all statutes dealing with the incorporation and governance of not-for-profit entities, and covering all community societies (and trusts), being brought together into one statute. That seems logical and would make the relevant law more readily accessible, but would also enable the legislation to be based on a set of philosophically consistent principles.

An omnibus statute dealing with the incorporation and governance of not-for-profit entities into one statute and covering all community societies (and trusts), such as the Incorporated Societies Act, Charitable Trusts Act, Agricultural and Pastoral Societies Act (to say nothing of the many special statutes enacted to assist individual Agricultural and Pastoral Societies), but also the Industrial and Provident Societies Act 1908, and (at least) the Friendly Societies and Credit Unions Act 1982 seems highly desirable

Q6: Can Industrial and Provident Societies that are conducted for business purposes be incorporated under the new statute?

Yes: refer to the comments in response to Questions 3 – 5.

Chapter 2 – The constitution of societies

Q7 Do the New South Wales' requirements for matters that must be dealt with by a constitution offer a good starting point for New Zealand legislation? Have you any other suggestions about other types of rules that might be required?

The Law Society agrees that the New South Wales' requirements for matters that must be dealt with by a constitution offer a good starting point for replacement New Zealand legislation. The present minimalist list in the Incorporated Societies Act (and the absence of any list in the Charitable Trusts Act) results in important issues simply not being considered by many people preparing society constitutions.

The New South Wales list of minimum requirements is more extensive, including as it does:

- Any qualifications for membership (but not how members are admitted – an omission that should be rectified; perhaps as in section 6(1) of the British Columbia Society Act 1996),
- The register of members (the provisions of section 70, British Columbia Society Act 1996, are comprehensive),

- Entrance fees, subscriptions and any amounts to be paid by members,
- The liability (if any) of members to contribute towards the debts and liabilities of the society or the costs, charges and expenses of its winding up,
- Any procedure for the disciplining of the members and any disciplinary appeals,
- How disputes between members (and between members and the society are to be dealt with),
- The constitution and functions of the committee (including election or appointment of the committee members, terms of office, grounds on or reasons for which committee vacancies occur, filling of casual vacancies, the quorum and procedure at committee meetings),
- The intervals between general meetings and how they are called,
- The time within which and how notices of general meetings and notices of motion are to be given,
- The quorum and procedure at general meetings, and whether members can vote by proxy at general meetings,
- What kinds of resolution may be voted on by postal ballot,
- The sources from which the funds are to be or may be derived,
- How funds are to be managed and how cheques are drawn and signed,
- The custody of books, documents and securities,
- The inspection by members of books and documents, and
- The financial year.

The Law Society believes that in addition to the New South Wales list, provision should be made for:

1. Meetings held by bringing people together via Internet connection (with or without visual contact),
2. Electronic notification of meetings (at least by email to those members with email addresses),
3. Electronic banking,
4. Remote ballots (both by mail, email and by voting through websites), and
5. Incorporating into the statute a schedule setting out a basic (amendable) set of standing orders for meetings (but avoiding the complexity and confusion in the Standards Association of New Zealand, *Model Standing Orders for Meetings of Local Authorities*

and Community Boards, NZS 9202:2003 and Model Standing Orders for Meetings of Public Bodies, MP 9204:1993).

In addition, some attempt might usefully be made to:

- draw out the practical implications of the distinctions between governance and management functions,
- set out minimum rules for dealing with conflicts of interest, and
- explicitly provide for the review of accounts as an alternative to expensive audits.

Q8 Australian jurisdictions provide for model rules that an incorporated association is deemed to have accepted unless it expressly decides to derogate from a rule by providing its own version. Do you agree that New Zealand should adopt this approach?

On balance, the Law Society favours this approach, but also notes the problems associated with adopting a “one size fits all” approach. As pointed out in the introductory comments above, there are challenges associated with making new legislation adaptable to the different types of entities, most of which rely on volunteer effort for governance and management.

Many of the existing problems arise because constitutions are drawn by people without the requisite expertise (either the technical expertise or an adequate knowledge of the way an entity operates), or the constitutions have become out-dated. Those problems will not be cured by foisting on societies a model set of rules because their adaptation to the needs of a society will still require some technical expertise and an adequate knowledge of the way an entity operates. However, the problems arising from the model rules approach are likely to be less serious than those that arise at present.

The Registrar currently undertakes a basic check that rules meet minimum standards for content but that does not ensure that the rules registered actually are comprehensive or make sense. The Law Society anticipates that if the new legislation contains a basic set of coherent rules upon which inexpert drafting can be based, that should avoid or minimise some of the problems that arise from many badly prepared constitutions. (The model rules in the British Columbia Society Act 1996 are reasonably comprehensive – although that statute draws a somewhat confusing distinction between a constitution and bylaws which appear to mean the same thing).

Nevertheless, if a regime involving model rules is introduced there are likely to be problems associated with inconsistencies between the model rules deemed to apply and efforts made to adapt them to meet the needs of a particular society. This problem will be exacerbated if the model rules are later changed (see the response to Question 10). The Law Society also notes that for the new legislation to deliver the intended improvements there will need to be greater scrutiny of rules (and amendments) before registration, and better resourcing of the Registrar to undertake this work.

The Law Society notes that there is currently no formal education (at least, of which it is aware) in New Zealand on either society law or the drafting of society constitutions. The provision of a more comprehensive incorporated societies statute and model rules may provide those professionals engaged in such drafting with a greater degree of understanding of the relevant issues and of the desirable features of a good set of rules.

Q9 If there is to be a division between members' benefit and public benefit societies, should there be different generic codes of rules?

Yes if the question is directed to the differences between charitable and other societies – and see, also, the Law Society's response to Question 4. If the division is between charitable and non-charitable societies, the differences between the different sets of rules are unlikely to be extensive; for charities, the purposes clauses, excluding member benefits, and controlling the extent to which members may benefit financially from a society (any transactions being on an arms-length basis), and distribution of assets on dissolution. However, as noted in the comments on Question 4, provisions should also be included for the incorporation of charitable trusts within the same statute.

Q10 If model rules are implemented, when a rule has been superseded by a new rule, should the society to be deemed to be governed by the new rule as opposed to the old one?

The Law Society believes the problem highlighted by this question is inherent to any statutory regime involving model rules. The Law Society suggests that there should be a transitional period – perhaps two to three years – during which a society can consider the implications of changes (given that most societies only have one general meeting a year).

Q11 Whereas, in New South Wales, rules are merely required that govern discipline, the Victorian legislation explicitly sets out certain natural justice aspects (for example, the disciplinary procedure is handled by an unbiased decision maker). Do you agree that the Victorian approach is the preferable one for New Zealand? If not, why not?

The Law Society understands that among the most common problems faced by societies are those relating to complaints against members and how (well) they are handled. Because the individuals initially dealing with complaints are usually untrained in the law, the Law Society would prefer to have prescribed minimum standards of natural justice for the disciplinary procedures of societies set out in the statute, as in the Victorian legislation.

The Law Society believes that:

- Establishing a set of default rules would not be desirable because of the different levels of sophistication of society membership and structures associated with the different types of entities (as discussed in the introductory comments, above),
- There should be no blurring of the distinction between a membership disciplinary issue, and issues created by differences between members and those governing or managing a society, and
- In either case, having some form of alternative dispute resolution service would be desirable (see the response to Question 16, below).

Q12 How should the requirement be phrased?

The Victorian statute provides a basic model, but omits reference to natural justice principles involving the period of notice of grounds of a complaint, providing for preparation time, or the ability to call people in support.

Q13 Should a society require a minimum number of members, to be incorporated? If yes, what minimum number of members do you consider would be appropriate? The current number is 15. Australian statutes require five.

The Law Society believes that this is a policy issue to which there is no objectively correct answer, and notes that the minimum number under the Charitable Trusts Act is five rather than the 15 under the Incorporated Societies Act. The Law Society notes that companies can now have a sole shareholder, but companies are usually formed for commercial purposes. In contrast, societies, by definition, are usually formed to enable people to associate together for non-commercial purposes. Given that distinction, setting the minimum number of members (whether for initial incorporation or for continued statutory recognition) for a society is a philosophical issue, and essentially addresses the question of the point at which the state should afford a group of like-minded people the ability to obtain (or retain) the benefits of a society's incorporation. The Law Society suspects that 15 is sometimes too high a number, and therefore the Australian (and British Columbian) approach of five may be preferable.

Q14 Do you have views on whether it might be advantageous to require societies to form governance committees, or appoint any particular type of officer?

In response to Question 7 the Law Society has already suggested the need to address the distinctions between governance and management functions in societies. That may be one reason why Australian statutes require societies to have governance committees, and could support requiring societies to form governance committees or appoint particular types of officer. However, as long as a society is governed in accordance with the rules adopted by the membership, there seems to be no reason why the state should require it to be governed by a committee rather than by all the members in general meeting or even autocratically by one person.

Q15 Is it appropriate to move towards a name regime similar to that in the Companies Act?

The Law Society notes that, unless a society is engaging in business, the Fair Trading Act is unlikely to apply to society names and an action in passing off would face some difficulties, and intellectual property laws would also have some limitations.

The Companies Act prevents the registration of names identical to existing or reserved company names, while the Incorporated Societies Act also precludes closely similar names. As far as the Law Society is aware, the present legislative provisions work well in practice so there seems to be no compelling reason for any change, although there may be merit in having one register for all names for incorporated bodies and also providing for societies to reserve names.

Q16 Does your experience suggest that there is a greater role for a regulator of this sector, beyond the role currently played by the Charities Commission, or the Registrar of Incorporated Societies? If so, what would that role be?

In essence, yes. At present regulation or enforcement options are extremely limited. The Registrar currently has very limited powers of investigation and enforcement, which appear to be rarely exercised, and for which he is provided with few resources. That leaves dissatisfied members with limited options; to seek change or redress internally, to "grin and bear" perceived or actual irregularities, to leave a society, or to have recourse to the High Court by seeking judicial review. High Court litigation is costly and, other than where there are grounds for seeking an urgent hearing, usually involves lengthy delays. Unresolved disputes within societies are stressful for those involved, potentially divisive or destructive for a society, and expensive for

all involved (the Law Society has been made aware of two High Court sets of proceedings which would each have cost the societies and their members over \$250,000).

The Law Society believes that having a body (possibly the Registrar) with investigative and adjudicative roles could be valuable, but that would inevitably be costly. The experience of the Law Society's members is that even the apparently simplest of issues requires careful investigation, often reveals problems that the complainant may be unaware of, and seldom involves less than 10 hours' work. The Law Society is also conscious that, apart from the issues of delay and costs in seeking court intervention, there are two other reasons to seek resolution other than through court processes:

- (a) First, court processes most commonly result in there being winners and losers, and the nature of the adversarial process is that opposing views are likely to become more entrenched and the inter-personal problems more intractable. While unresolved disputes within societies are usually potentially divisive or destructive for a society, their resolution through the courts seldom results in reconciliation. That suggests that a more investigative approach may have merit. Subject perhaps to a limited right of appeal, an investigator's recommendations could be binding.
- (b) Second, a dispute resolution service could be staffed by people with expertise in societies and charities who can, by reason of that expertise, more readily identify relevant facts and legal issues than lawyers and judges less familiar with society and charity law and practice.

Any alternative to the status quo would involve cost, but that cost is likely overall to be significantly cheaper than what all parties would incur by obtaining separate legal representation and paying court fees. While the initial cost would necessarily have to be funded by the government, if complainants, respondents and societies were required to use a dispute resolution service before recourse to the courts, the participants and beneficiaries could be required to fund the service by deposit of fees when a dispute was submitted to the service (and, possibly, by "top-ups" as the investigation proceeded), and with the service having the power to order any re-distribution of the cost in its determinations. The investigator's conclusions should be binding on the members and society concerned, subject to rights of appeal to the courts (which might be limited by reference to the nature of the issues or could be modelled on the limited rights of appeal under the Arbitration Act). The Law Society believes this proposal deserves further consideration.

Q17 Is a general variation power justified? Who would appropriately exercise it and what safeguards ought to exist to prevent its misuse?

The Law Society believes that this question is related to the last question, as complaints of impropriety often identify problems with the rules of a society. On occasions (see, for instance, *Murray v The Hearing Association Hastings Branch (Inc)*, High Court, Napier, CP 28/99, 15 March 2000), societies find that they have adopted inappropriate rules which they may find it difficult or impossible to change. There should be a way of resolving such problems without the need to apply to the High Court. The Law Society favours the Registrar being given that power, and/or it could be one of the functions of the type of dispute resolution service mentioned in the response to Question 16. Certainly, the present requirement to seek intervention of the High Court is unsatisfactory as it is costly and takes time.

Chapter 3 – Good governance

Q18 Do you agree that the new Act should provide a ‘code’ of duties that committee members must observe in their decisions?

Q19 If so, what duties ought to be included in the code?

The problem of committees becoming laws unto themselves, acting dictatorially, and becoming a clique remote from many members is common, but that does not highlight a failure of the legislation. Rather it is a consequence of factors such as member apathy, lack of understanding of good governance practice, and failures of accountability and transparency. The reality is that it is not possible to legislate for good behaviour, but some form of code would be useful, preferably combined with an improved dispute resolution procedure. At present common sense responsibilities such as are found in the Companies Act are not found in any legislation relating to not-for-profit organisations.

In the Law Society’s view, the model in the Companies Act is not immediately transferable to societies, but provides a useful and adaptable model for any new societies statute, and one superior to the very limited code found in, for instance, section 25 of the British Columbia Society Act 1996.

Q20 In what respects might the Companies Act obligations need to be altered if included in a new Incorporated Societies Act?

As indicated, the Law Society considers the Companies Act code a useful and adaptable model for any new societies statute, perhaps as summarised in paragraph 3.5 of the Issues Paper, but omitting from the last bullet point “taking into account (without limitation) the nature of the company, the nature of the decision, and the position of the director and the nature of the responsibilities undertaken by him or her.”

Q21 Our preliminary view is that some minimum standards of conflict of interest rules ought to be part of the new statutory regime, as they are in the Companies Act. Do you agree?

Yes. It is only in recent years that the significance of conflict of interest issues for voluntary organisations has been highlighted and better understood. It is now common to find conflict of interest declarations on meeting agendas and conflict of interest registers adopted as good governance practices. Regrettably, many believe that only financial interests need to be declared (a problem also experienced with members of local authorities and various other statutory bodies) so the requirements need to be more broadly spelt out.

The provisions of the British Columbia Society Act 1996 appear to provide a good, succinct model:

Disclosure of interests

27 A director of a society who is, directly or indirectly, interested in a proposed contract or transaction with the society must disclose fully and promptly the nature and extent of the interest to each of the other directors.

Accountability

28 (1) A director referred to in section 27 must account to the society for profit made as a consequence of the society entering or performing the proposed contract or transaction,

- (a) unless
 - (i) the director discloses the interest as required by section 27,
 - (ii) after the disclosure the proposed contract or transaction is approved by the directors, and
 - (iii) the director abstains from voting on the approval of the proposed contract or transaction, or
- (b) unless
 - (i) the contract or transaction was reasonable and fair to the society at the time it was entered into, and
 - (ii) after full disclosure of the nature and extent of the interest in the contract or transaction it is approved by special resolution.

(2) Unless the bylaws otherwise provide, a director referred to in section 27 must not be counted in the quorum at a meeting of the directors at which the proposed contract or transaction is approved.

Validity of contracts

29 The fact that a director is, in any way, directly or indirectly, interested in a proposed contract or transaction, or a contract or transaction, with the society does not make the contract or transaction void, but, if the matters referred to in section 28 (1) (a) or (b) have not occurred, the court may, on the application of the society or an interested person, do any of the following:

- (a) prohibit the society from entering the proposed contract or transaction;
- (b) set aside the contract or transaction;
- (c) make any order that it considers appropriate.

Q22 Do you agree that there should be a requirement for the disclosure of financial interests? Do you agree there should be a further requirement to disclose other material personal interest?

The Law Society responds affirmatively to both questions, and believes the proposal suggested in answer to Question 21 may adequately cover those issues.

Q23 What should be the consequence of a disclosure of either financial or other material personal interest? The Companies Act requires disclosure only, but there are other options: recusal from voting, or recusal from the meeting. Which do you consider appropriate, and why? Should there be different types of consequences, depending on whether the matter disclosed is financial, or other material personal interest?

The Commission records the conflicting approaches to this issue in paragraph 3.17 of the Issues Paper. The Law Society acknowledges that “presence of the conflicted committee member may well influence the decisions taken by the non-conflicted members” but suggests that requiring that person to be absent would be unrealistic and burdensome for the majority of societies, as the individual often has information of value to contribute (particularly where the conflict is not pecuniary in nature). Perhaps the Western Australian and South Australian approaches could be applied to smaller societies (perhaps those with fewer than 100 – 200 members and/or less than \$1 million in assets), and a stricter regime such as those adopted in New South Wales and Victoria could be applied to larger societies (perhaps those with more than 100 – 200 members and/or more than \$1 million in assets).

Q24 What are your views on the criminalisation of failure to disclose a conflict of interest? Might civil penalties be preferable, for failures under the Act that do not amount to deliberate dishonesty?

The Law Society agrees that civil penalties are preferable for failures under any new Act that do not amount to deliberate dishonesty.

Q25 Does there need to be a general prohibition on the “dishonest use of position”?

Yes. While the availability of criminal law sanctions when those governing community organisations misbehave may appear somewhat draconian, many society and trust problems do involve the “dishonest use of position,” so a prohibition would be useful. The Law Society believes that this would be a very useful provision, not only as an educative signal to committee members but also to penalise those who act in a dishonest way. The Law Society believes that Section 33 of the New South Wales legislation is simple yet comprehensive.

Q26 Would it be useful to allow courts to consider banning individuals from being committee members of incorporated societies in the same way as individuals can be barred from being directors?

Yes. Where the courts have to deal with disputes within community entities, the conduct of those in governance is commonly scrutinised with some rigour. The Law Society believes that being able to seek a banning order as one of the remedies in civil proceedings would enable the courts to impose sanctions where conduct falls below minimum standards, in addition to this being a valuable provision when dealing with prosecutions.

On the principle that prevention is better than cure, there would also be merit in the statute providing that certain people not be permitted to be involved in the governance and management of societies – such as:

- those banned under the Companies Act and the new societies legislation,
- anyone held by a court of competent jurisdiction to have been guilty of misconduct in the administration of a society or trust,
- anyone convicted of a crime involving dishonesty as defined by Section 2 of the Crimes Act 1961, and
- anyone suffering from a mental disorder within the meaning of the Mental Health (Compulsory Assessment and Treatment) Act 1992.

Q27 Would enabling the Registrar to take actions on behalf of the society to recover compensation or seek an account of profits be appropriate?

As identified in answer to Question 16, there can be a high cost (diverting funds from community use) associated with disputes within community societies and trusts, which suggests that this question should be answered “yes.” In principle, the Law Society believes that this would be desirable, as long as the Registrar was adequately funded to undertake investigations and prosecutions.

Q28 Does there need to be greater rigour than currently, around requirements for auditing and appropriate accounting standards? If not, why not? Do you agree that the new Act should provide for the imposition of audit and accounting standards by regulation that might be varied in accordance with the size of the society, and how ought that size be judged?

The Law Society considers it would be useful to provide some guidance for societies on the form their accounts should take (perhaps a schedule setting out a model for annual accounts), but is concerned that any such guidance should be proportionate. This is a good illustration of the adage that “one size does not fit all.” As already signalled in response to Question 23, the Law Society believes that some distinction can and should be drawn between smaller and larger societies, and suggests that “size” can be determined by reference to the number of members and the assets under the society’s control. What may be required of a society with millions in assets or thousands of members is quite inappropriate for a society that has no assets apart from a modest bank balance, and a dozen or so members.

The Law Society’s response to Question 7 suggested that provision should be made for the review of accounts as an alternative to audits, which are expensive and appear seldom to identify problems within societies and charitable trusts. For most community organisations the value of a formal audit is doubtful, and a review of the accounts and of governance practice is likely to provide better value for money for most organisations. For larger community societies and trusts an audit requirement would, however, seem reasonable (see, again, the Law Society’s response to Question 23).

A number of charities require that donee societies and trusts to which they make grants be audited as a condition of considering or making grants; some apparently are concerned that their charitable status may be imperilled if they make grants or donations to entities that use funds for non-charitable purposes. While this is perhaps not within the scope of the Issues Paper, the problem might be addressed by amending the Charities Act 2005 to make it clear that grants or donations to entities that use funds for non-charitable purposes will not endanger the charitable status of the donor as long as it has taken reasonable steps to ensure that the grant or donation will *prima facie* be used for charitable purposes.

Chapter 4 – The legal dealings of an incorporated society

Q29 Should the new Act grant incorporated societies the powers and privileges of a natural person, in the same way as is done in the Companies Act?

Yes. The Companies Act model was designed for commercial entities, and when enacted was perhaps somewhat controversial but now seems to be well-accepted. One of the problems is that societies and trusts tend to evolve over time, with their purposes and activities altering as they grow and become more mature, and limitations thought appropriate originally become irrelevant and unnecessarily limiting. The Companies Act model would still enable members to limit an entity’s powers, and such an approach would focus attention on those limitations, rather than, as at present, leaving the scope of the powers to the imagination and skill of those drafting a constitution.

The discussion in response to Question 3 drew attention to section 4 of the British Columbia Society Act 1996, and the Law Society notes that section 4(1)(d) expresses a society’s “powers and capacity” as being such “as may be required to pursue its purposes.” That phrase appears to limit the empowerment of a society, leaving open scope for an *ultra vires* argument.

Q30 Do you agree that the new statute should limit the ultra vires doctrine, and if so, how? Which model is preferred, the Companies Act one, or the New South Wales’ one?

The Law Society believes the answer to this question depends in part on, and is intimately related to, the answer to the last question:

- As a minimum, the New South Wales approach – giving third parties the benefit of being able to assume that an entity’s constitution permits the transaction unless the third party has contrary knowledge – appears fair and logical.
- If entities are to be given the full powers of a natural person then there appears to be a strong philosophical argument that the Companies Act approach should be preferred. Section 24(3) of the British Columbia Society Act 1996 contains such a provision: “A limitation or restriction on the powers or functions of the directors is not effective against a person who does not know of the limitation or restriction.”

Chapter 5 – Resolving disputes between members and their societies

Before responding to the questions in Chapter 5, the Law Society wishes to discuss the contract theory covered in paragraphs 5.7 – 5.9 of the Issues Paper.

Citing *Finnigan v New Zealand Rugby Football Union Inc*¹ but also following many other previous New Zealand court decisions, the High Court very recently observed that while a society “is a private body, with a constitution that takes effect as a contract as between its members, it is also a society incorporated under the Incorporated Societies Act 1908.”² That highlights two points:

- (a) The English courts have for a long time characterised the relationships between club and society members as being contractual. That rationalisation is required because there is no general statutory framework for the incorporation of community clubs and societies. In New Zealand we have had, for a very long time, statutes providing for the incorporation of societies,³ and therefore the Law Society suggests that the contractual analogy is neither necessary nor particularly helpful.
- (b) Society members clearly have a relationship with each other. That relationship is realised generally through democratic processes.

The judgment in *Tamaki v The Māori Women's Welfare League Incorporated* noted that:⁴

The constitution is a broadly cast document. Although last amended in 2008, it is stronger on conceptual values than on prescriptive, procedural detail. The constitution therefore needs to be construed in accordance with the core underlying values of the League. Respect, manaaki (embrace) and tautoko (support) are at the heart of the tikanga of the League.

While, with respect, the Law Society has some reservations about the possible implications of that statement (if it is interpreted to suggest that “core underlying values” can trump the provisions of a constitution), this statement emphasises that the will of members should be recognised and respected.

The Law Society suggests that any new legislation should remove the temptation to look for contractual analogies to justify court intervention. This might be done by explicitly providing that the relationship between members is governed by the provisions of the Act and the constitution of the society and such subsidiary rules as may be made in accordance with that constitution.

1 [1985] 2 NZLR 159 (CA), 177.

2 *Tamaki v The Māori Women's Welfare League Incorporated*, CIV-2011-485-001319, High Court, Wellington, 21 July 2011, Kos J, at [6].

3 Not just the Incorporated Societies Act 1908, but also the Charitable Trusts Act 1957 and legislation dealing with the agricultural and pastoral societies and industrial and provident societies.

4 CIV-2011-485-001319, High Court, Wellington, 21 July 2011, Kos J, at [43].

Q31 Do you agree that the Victorian model should be adopted, which gives wide powers to the court to make orders, plus the ability to decline to make an order on the grounds that the application was trivial, or the matter could have been more reasonably resolved in other ways?

At present none of the statutes assist in resolving disputes between members of a society with other members or the society itself. Decided cases indicate different judicial approaches to the legal relationships involved, and the remedies available may depend on the way cases are pleaded. The recommended Victorian approach is highly discretionary (which seems sensible), but it depends on the experience of the court exercising the discretion. The decline in civil litigation in the District Court would mean that few District Court Judges would have the background experience to deal with such cases, and that may influence the answer to the question.

In response to Question 16, the Law Society has proposed an alternative dispute resolution service, and the Law Society considers that this proposal should be considered further.

Q32 Do you agree that the Act should provide for disciplinary procedures to be kept separate from those designed to resolve disputes between members, with members being prevented from taking a grievance procedure until any disciplinary procedures have been concluded?

If this question is suggesting that internal remedies should be exhausted first before seeking external intervention that seems appropriate to the Law Society. However, the Law Society observes that many “disciplinary” issues are a manifestation of other issues where the members are in dispute, so the distinction may be artificial. As observed in answer to Question 11, the distinction between a membership disciplinary issue and disputes created by differences between members and those governing or managing a society should be recognised.

Q33 Should there be any limits on the types of cases with which a court can deal? If so, what types, and why?

As far as the Law Society is aware, the current practice of the courts declining to intervene where an organisation’s decisions deal with tenets of religious faith works well.⁵ The Law Society does not favour extending that practice to cultural issues generally as that has greater potential to create issues of definition and uncertainty as to the extent of any prohibition. The Law Society recognises that the potential benefits of providing for issues involving Māori organisations to be referred to the Māori Land Court (as may occur under the Resource Management Act 1991 where there are disputes as to who is mana whenua or mana moana), but favours that being at the direction of a court on application or of its own motion.

Any new legislation also needs to be consistent with the jurisdiction of the Sports Tribunal established under the Sports Anti-Doping Act 2006.

Q34 Should the new legislation include provision for derivative actions by society members, similar to section 165 of the Companies Act?

The Law Society is not aware of any need to make any such provision.

Q35 Do you agree that a general remedial power should be given to the court to do what is “just and equitable”?

⁵ See *Law of Societies in New Zealand*, Mark von Dadelszen, 2nd Edition, 2010, LexisNexis, 5.5.6 at page 114.

The Law Society believes that a court should be able to do what is broadly just and equitable, but would prefer the Registrar to have at least initial remedial powers (see the responses to Questions 16 and 17).

Q36 Have the current provisions about branches created any problems, and how might the provisions be altered to avoid those problems?

Q37 Is there still a need for branch societies?

The Incorporated Societies Amendment Act 1920 provisions for branches are clumsy, and when disputes or problems arise, totally inadequate. The Law Society commends to the Commission for consideration the approach in the British Columbia Society Act 1996:

Branch societies

- 18 (1) A society may, if authorized by its bylaws, establish and maintain one or more branch societies with the powers, not exceeding the powers of the society, that the society confers.
- (2) If a society establishes a branch society, it must without delay send the registrar a notice setting out the following:
- (a) the date the branch society was established;
 - (b) the branch's name, location and powers;
 - (c) the other information the registrar requires.
- (3) Subsection (1) does not apply to a society whose purposes include operating a social club.
- (4) Without the consent in writing of the registrar, a branch society must not use a name other than the name of the society that established the branch society together with
- (a) words describing the geographical location of the branch society or other distinguishing words, and
 - (b) the word "Branch".
- (5) If a branch society ceases to exist, the society that established it must without delay send the registrar a notice setting out the following:
- (a) the name and location of the branch;
 - (b) the date the branch ceased to exist;
 - (c) the other information the registrar requires.

Incorporation of branch societies

- 19 (1) If a branch of a society or extraprovincial society wishes to be incorporated under this Act, it must, in addition to any other requirement of this Act, file with the registrar a certificate under the seal, if any, of that society consenting to the incorporation, and must comply with any term or condition mentioned in the certificate.
- (2) A branch society so incorporated must not exercise a power conferred on a society under this Act, without first obtaining the written consent of that society, if the exercise of that power is prohibited by or in conflict with
- (a) the constitution or bylaws of the society to which it belongs, or
 - (b) a term or condition of the certificate filed under subsection (1).
- (3) If the certificate filed under subsection (1) so provides, the constitution and bylaws of the branch society are deemed to include
- (a) the constitution and bylaws of the society giving the certificate, or
 - (b) the portion of the constitution and bylaws mentioned in the certificate,
- but the powers of a branch society must never exceed the powers conferred on a society under this Act.

Chapter 6 – The Liquidation and Dissolution of Societies

Q38 Have you experienced problems with the liquidation or dissolution provisions?

Q39 In what ways can the procedure for liquidation and dissolution be improved?

Q40 In particular, should the double meeting requirement for members' liquidation be altered?

The Law Society is not aware of any particular problems and it appears that the present provisions work reasonably well. The assumed rationale for the double meeting requirement in section 24(1) of the Incorporated Societies Act is to avoid liquidation occurring without all members having the opportunity to reflect on the wisdom of winding-up. In practice, however, once members lose enthusiasm for maintaining a society, expecting them to meet once, let alone twice, does cause practical difficulties in achieving a quorum. One meeting should suffice, but possibly with minimum statutory periods of notice to members and a requirement for the proposed motions and the reasons for them being set out in full.

There are two other issues any reform might usefully address:

- Whether an informal method of winding up (by simply advising the Registrar that the entity is no longer operating)⁶ should be legitimised, and
- Clarifying the status of a society dissolved by the Registrar.⁷

Q41 What are your views on the division of incorporated societies into two types, requiring them to register for either members' benefit or public benefit? If this is not supported, how should the distribution of assets on dissolution be dealt with? Should it never be permitted?

The distribution of assets on dissolution should never be permitted – and see the Law Society's comments on Questions 4 and 9.

Q42 Should there be a provision for mergers of societies?

In practice, at present mergers are achieved either as a take-over of one society by another, or the formation of a new society with the two former societies transferring their assets to the new society. This is frequently a costly business because there is at present no simple way of amalgamating two or more societies, and there can be difficulties and unnecessary expense to effect the transfer of assets and liquidation of the former societies. This and the associated issue of reregistration under another statute are discussed at 4.8 in *Law of Societies in New Zealand*, Mark von Dadelszen, 2nd Edition, 2010, LexisNexis (footnote numbering differs from that in the text):

4.8 Mergers, amalgamations, and reregistration

4.8.1 Mergers and amalgamations

There is no statutory provision in New Zealand for the merger or amalgamation of separate incorporated societies or charitable trusts. In contrast, most Australian states provide for the amalgamation of societies.⁸ The Companies Act 1993 sets out two alternative procedures for the amalgamation of companies in Part 13, and there are procedures available for the amalgamation of friendly societies and credit unions in the Friendly

⁶ See 12.2.1 of *Law of Societies in New Zealand*, Mark von Dadelszen, 2nd Edition, 2010, LexisNexis

⁷ *Ibid*, 12.2.4.

⁸ See K L Fletcher *The Law Relating to Non-Profit Associations in Australia and New Zealand* The Law Book Company Ltd, 1986, pp 41–43 and 280–283, and *Consultation Paper on Proposals for a New Society Act*, British Columbia Law Institute, August 2007, pp 114–120.

Societies and Credit Unions Act 1982.⁹ Some similar provision in the Incorporated Societies Act 1908 would be useful.

In the absence of a statutory scheme to effect mergers, the most practical way of achieving a merger or amalgamation may be to dissolve one or more of the existing entities and to transfer assets to one, possibly new, entity before or on dissolution.¹⁰ Careful consideration needs to be given to the rules of the existing entities as to the distribution of surplus assets following a winding up,¹¹ and as a preliminary step it may be necessary for the existing entities to amend their rules to provide that on winding up their net assets are to be distributed to the remaining or new entity. An alternative to the statutory winding-up procedures, involving less cost and formality, is to transfer assets to the remaining or new entity and to advise the Registrar that the entity has ceased operations or simply to allow the existing entities to become dormant and, eventually, struck off by the Registrar.¹²

Members of entities going out of existence on a merger or amalgamation need to join the remaining or new entity¹³ as their membership cannot be automatically transferred unless the rules of the entity they are joining deem them to be members. As membership is voluntary,¹⁴ that may be undesirable and, further, because of the contractual obligations inherent in membership,¹⁵ there is a powerful argument that no person can be deemed to be a member of a society to which that person does not deliberately agree to belong.

4.8.2 Reregistration under another Act

Again, there is no statutory mechanism for an entity registered under either of the Incorporated Societies Act 1908 or Charitable Trusts Act 1957 to reregister under the other Act or, indeed, under the Companies Act 1993, or vice versa.

While the legislature could provide such a mechanism,¹⁶ there are two fundamental issues which would need to be addressed by any such legislation. First, a registered body corporate is a distinct legal entity from any other, and registration under another statute creates a new legal entity.¹⁷ Secondly, at least in the case of applications under the Charitable Trusts Act, one of the requirements for registration is that the entity not be already registered.¹⁸ The latter Act recognises that charitable entities may register under other legislation, but expressly prohibits entities registered under the Charitable Trusts Act from incorporating under any other Act.¹⁹

Registration of charities with the Charities Commission, whether or not incorporated, is provided for under the Charities Act 2005.²⁰

9 Respectively, in ss 83 and 135.

10 See ch 12 on dissolution. This method of achieving a merger is, legally, the best as it winds up the old entities, clearing any actual or contingent liabilities, and starts afresh.

11 See para 12.6.

12 See para 12.2.

13 See paras 5.1.1 and 5.2.

14 See paras 3.1 and 5.1.1.

15 See para 5.1.

16 As it does for friendly societies under s 84 of the Friendly Societies and Credit Unions Act 1982, and for building societies under Part VIIA of the Building Societies Act 1965.

17 In *Dunedin United Friendly Societies Dispensary v Pharmacy Authority* [1999] 3 NZLR 233 the High Court held that on application for registration as a company under the Companies Act 1993 of a registered friendly society, the assets of the friendly society would not automatically vest in the company, and the company would not be entitled to the friendly society's exemptions under the Pharmacy Act 1970 as the friendly society and the company were two separate legal entities.

18 Charitable Trusts Act 1957, ss 7(2) and 8(2) and Second Schedule forms.

19 Section 22.

20 See para 13.3.

The British Columbia Society Act 1996 has a simple and, on the face of it, eminently workable solution:

Amalgamation of societies

- 17 (1) Unless one or more of them is a grandfathered insurance society as defined in section 200 of the Financial Institutions Act, 2 or more societies may apply to amalgamate and form a new society by sending the registrar copies, in duplicate, of the special resolutions that authorize their respective directors
- (a) to jointly sign a constitution and bylaws in the form established by the registrar for the purposes of this section, and
 - (b) to comply in other respects with section 3.
- (2) Provisions of this Act that apply to the incorporation of a society apply to the amalgamation of 2 or more societies as if the amalgamation were the incorporation of the amalgamated society.
 - (3) After the issue of a certificate of incorporation to the new society, the former societies are dissolved, and all property and rights of those societies pass to and vest in the new society without further act or deed.
 - (4) An amalgamation under this section does not adversely affect the rights of a creditor of a former society, and the new society is liable for all debts and obligations of the former societies.
 - (5) On production of the required evidence, the estate and interest of the former societies in land registered under the Land Title Act must be registered in the name of the new society, but the new society is exempt from the payment of fees calculated according to the value of that estate or interest.

Chapter 7 – Transitional Issues

Q43 What are your views on workable transitional arrangements? Do you support the Companies Act approach, which enabled re-registration of existing companies, and provided that those that did not would be deemed to have done so? Should there be a longer transitional period in relation to the adoption of model rules?

Q44 How can we minimise the costs for societies in the transitional period?

The Law Society considers that it would be sensible to have a transition involving, like the Companies Act 1993, re-registration of societies, with deemed re-registration of those that fail to act. That would give all societies the benefits of the reforms and minimise costs, and seems a workable approach. However, any reform needs to bear in mind the considerable variety of entities likely to be covered by any new statute and the practical problems faced by societies run by volunteers, as pointed out in the introductory comments above.

We hope these comments are helpful to the Commission. The Law Society would be happy to contribute to any further consultation on the proposed reforms. Contact can be made in the first instance through the secretary of the Law Society's Law Reform Committee, Vicky Stanbridge (ph (04) 463 2912 / vicky.stanbridge@lawsociety.org.nz).

Yours sincerely



Anne Stevens
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