Commercial eSpeaking

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BMC LAWYERS

ISSUE **65** | Spring **2023**

Welcome to the Spring edition of *Commercial eSpeaking*; the last issue for 2023.

In this edition, our main story focuses on the Mainzeal case where the Supreme Court found that four directors had traded recklessly and while the company was insolvent.

We hope you enjoy reading this e-newsletter, and that the content is both interesting and useful.

If you would like to talk more about any of the topics covered, or indeed on any legal matter, please don't hesitate to contact us. Our details are on the top right of this page.

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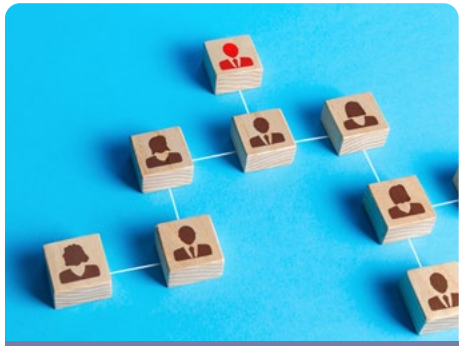

Mainzeal decision

Major implications for company directors

Taking on the responsibility of a directorship is not a decision to be taken lightly. For New Zealand directors, the magnitude of the director role has been hammered home with the decision of the Mainzeal case from the Supreme Court in late August.

This decision has sent a strong signal from the New Zealand justice system that directors can, and will be, held personally liable for financial losses experienced by creditors if the directors allow the company to trade recklessly and/or trade while insolvent.

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New retention monies legislation gives better protection

Comes into force on 5 October

The Construction Contracts (Retention Money) Amendment Act 2023 will come into effect on 5 October.

The intention is to provide greater clarity, and to strengthen the rules, regarding retained funds under the Construction Contracts Act 2002.

If your business retains funds as part of a construction contract, or a contractor retains funds from you, you should ensure you are familiar with these upcoming changes.

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Lego wins trade mark dispute with Zuru

The recent case of *Zuru v Lego* reminds all businesses that any use of another trader's registered trade mark carries significant legal risk.

Start preparing for the Incorporated Societies Act 2022

This new legislation comes into force on 5 October. Societies must re-register and file a new (or updated) constitution, amongst other things, by 5 April 2026.

ESG and directors: the Companies (Directors' Duties) Amendment Act 2023 now in force

Clarifying that company directors may consider environmental, social and governance matters as well as profit maximisation.

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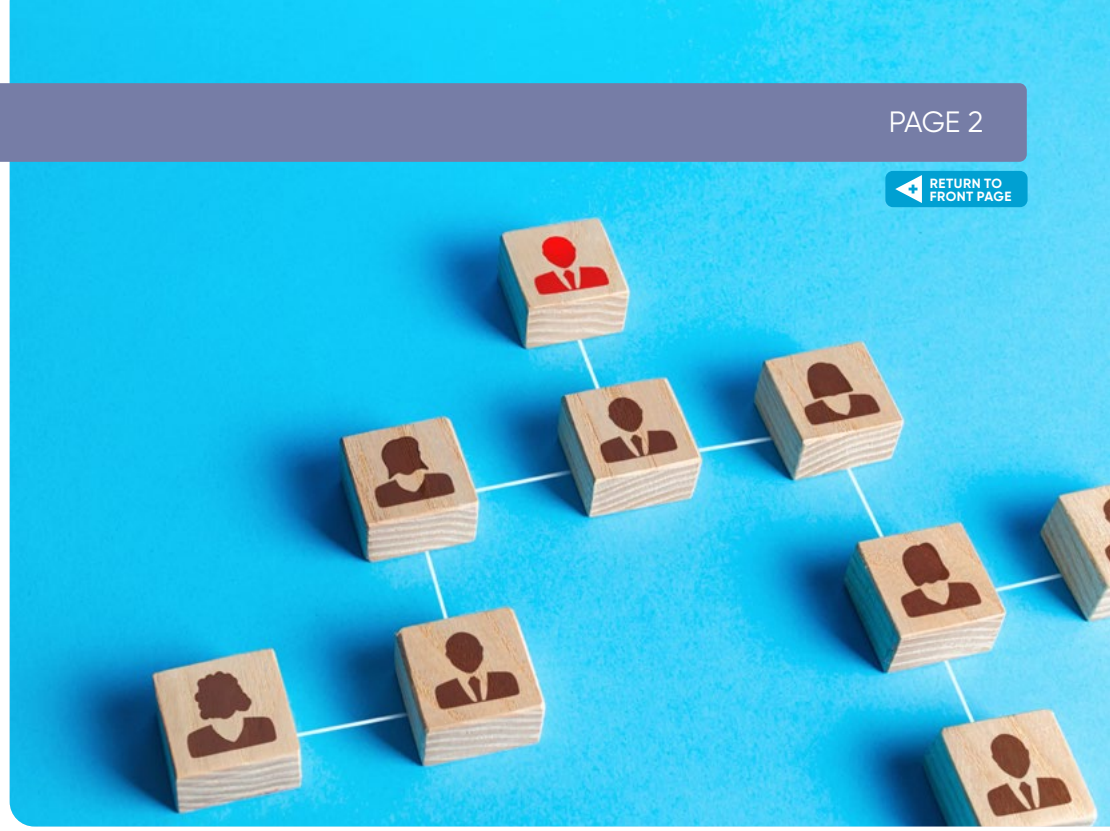

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Taking on the responsibility of a directorship is not a decision to be taken lightly. For New Zealand directors, the magnitude of the director role has been hammered home with the decision of the Mainzeal case from the Supreme Court in late August.[1]

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About Mainzeal

Mainzeal Property and Construction Limited was one of the largest New Zealand construction companies in the years leading up to its financial collapse.

In 2013, the company went into receivership and liquidation owing unsecured creditors around $110 million. The Mainzeal liquidators believed that the directors of the company had breached s135 (reckless trading) and s136 (insolvent trading) of the Companies Act 1993 and should be held personally liable for the losses of the company's creditors.

Supreme Court decision

While going into the nuances of each of the court hearings is too complex for the scope of this article (the Mainzeal case has been heard in the High Court, Court of Appeal and Supreme Court), it is noteworthy that each court accepted that the directors should be held personally liable to some extent for a breach of their director's duties.

At the highest court in New Zealand, the Supreme Court, the judges found that the directors should be liable for $39.8 million plus interest payable at 5% pa from the date of liquidation (together more than $50 million). The chief executive of Mainzeal is responsible for the full sum, and the liability of the three other directors was capped at $6.6 million each plus interest.

Facts rather than intentions

Critically, personal liability falling on a director due to a breach of directors' duties under s135 (reckless trading) and s136 (insolvent trading) is a matter of facts, not intentions.

The Mainzeal directors were not accused of any conflict of interest or lack of honesty, and were taken on their word that they acted with good intention while running the company. Regardless, it mattered that on the facts they permitted the company to trade in a way that was reckless and allowed the company to trade while it was insolvent.

Companies Act 1993 may need a refresh

Both the Court of Appeal and Supreme Court indicated that a review and update of the Companies Act will be helpful.

The Mainzeal case reinforces to directors the consequences of failing to avoid reckless or insolvent trading, however the current legislation does not provide additional guidance or safe harbour for directors and their decision-making. Adding new guidance for directors' duties into the Companies Act could enable directors to more confidently navigate the complexities of commercial decision-making with a need for accountability to their creditors.

Personal liability

After the announcement of the Supreme Court decision, many directors may want to take a moment to step back and allow the lessons of Mainzeal to sink in. Becoming personally liable for a company's debts is a significant risk associated with accepting (or continuing) a director role.

Every director of a company should ensure they feel adequately knowledgeable about all key aspects of their company and the sector in which it operates. Accepting a directorship role where there are gaps in skills, or knowledge of the company or sector, can lead to an increased risk that the director may unwittingly allow, or join their other directors in, a decision that permits the company to trade in a reckless or insolvent manner, opening up personal liability and prejudicing creditors.

If you are considering taking on a directorship, you should take independent legal and accounting advice to not only carefully assess whether your skills are a good match for the company and sector, but also to be clear on any potential personal liability.

If you would like some help in assessing whether a directorship is a good fit for you, please don't hesitate to contact us for further guidance. +

1 *Yan v Mainzeal Property and Construction Limited (in liquidation)* [2023] NZSC 113.

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Comes into force on 5 October

The Construction Contracts (Retention Money) Amendment Act 2023 was passed on 5 April this year with the legislation coming into effect on Thursday, 5 October 2023.

If your business retains funds as part of a construction contract, or a contractor retains funds from you, you should ensure you are familiar with these upcoming changes.

The primary intention behind the amendments is to provide greater clarity and to strengthen the rules regarding retained funds under the Construction Contracts Act 2002. The government wants these changes to provide more reassurance to subcontractors that they will be paid for work completed – even if a head contractor becomes insolvent.

Retention monies must be held separately

Previously, there was no obligation for the business retaining money to hold it in a separate account unless a trust relationship had been created.

From 5 October, all funds retained under a construction contract must be held in a separate bank account that meets specific criteria.

This bank account must be held at a New Zealand bank, with a chartered accounting or law firm, or by a trustee company; and the account provider must be told that it is an account holding funds on trust.

If you are required to retain funds, you may use that account for multiple contracts (you do not need an individual account for every contract with retained funds), but the account may not be used for any other purpose.

Reporting obligations

If you are retaining funds under a construction contract, you will also need to comply with reporting obligations on your retained funds account. If there is more than one party for whom you are holding funds, you must maintain a ledger that clearly indicates whose funds are coming in and out of the account, and report to each party individually.

On receiving funds to be retained, you must report as soon as practical to the party for whom you have retained funds. Your report must include:

- The amount being retained
- The date it was received
- Details of the bank account in which the funds are being held, and
- A statement that shows the funds in the account, including any deposits or withdrawals relevant to their retained funds.

You also must ensure that you regularly report to all parties; the Act specifies this means *at least* once every three months. These reports must also be produced promptly upon request from the party for whom you are retaining funds. As well, you may not charge for the administration of producing these reports.

Do note, however, that as the retention holder, you are entitled to the interest on the account; this presumably may help cover the account fees and maintenance.

Use of the funds

There must be agreement in place around when the funds are to be accessed. If there are any issues that arise during the contract that would result in the retained funds being used, *before accessing the funds* the holder of the retained funds must (at a minimum) provide notice of the intention to use the funds and why, and give at least 10 working days to the other party to rectify the issue.

Penalties

Significant penalties have been introduced to enforce the new legislation; failing to comply with the retained funds management regime is considered a criminal offence.

For each breach of the Act, a company can be fined up to $200,000 and each director can be fined up to $50,000.

Given that these charges are applicable *per offence*, there are serious financial consequences for non-compliance. The amendment also has added a fine for failure to report, or for false or inaccurate reporting (even if the funds are being held in a compliant manner), of $50,000.

Alternatives

Given the new significant penalties and associated additional administration for retained funds, many construction contracts are being amended so that the retention holder obtains a security bond in lieu of a retention.

The NZS 3910:2013, that is commonly used by the construction industry, does not set comprehensive criteria for how a bond should be provided or released. Therefore, any contractor who prefers to avoid running a retained funds bank account by using bonds, should carefully (and urgently) review and amend their contracts to ensure they comply with this new legislation.

If you are engaged in construction contracts and would like to discuss your obligations under the new amendments, please don't hesitate to contact us. +

Business briefs

Lego wins trade mark dispute with Zuru

The recent High Court decision in *Zuru v Lego*[2] is a reminder to all businesses that any use of another trader's registered trade mark carries significant legal risk.

The issue arose when Zuru used the words 'Lego brick compatible' on the packaging for its Max Build More building brick toys. Lego argued this infringed its registered trade marks.

Zuru attempted to rely on defences that it used Lego's mark in 'comparative advertising' and to 'indicate the intended purpose' of its product. The Trade Marks Act 2002 permits the use of another trader's registered trade mark for these purposes, provided such use is 'in accordance with honest practices in commercial matters.'

The court rejected the 'comparative advertising' defence, finding the statement did not actually compare Zuru's and Lego's products in any way.

The court also found that Zuru's use of 'Lego' did alert customers to a characteristic of Zuru's bricks in that they were compatible with Lego's bricks, but it was not done in accordance with honest practices. Relevant factors leading to this conclusion included:

- Zuru intended to gain market share from Lego by selling similar products at a cheaper price
- There were concerns that Zuru's actions were a ploy to strengthen Zuru's legal action against Lego in the USA, and
- Zuru did not obtain prior consent from Lego or advise Lego of its intention to use Lego's trade mark.

The court determined that Zuru's use of Lego in the compatibility statement was a deliberate attempt to leverage off Lego's established reputation and infringed Lego's registered trade mark rights.

If you are considering using another trader's registered trade mark for any reason, we recommend you talk with us early on. Otherwise, you could be on dangerous, and expensive, ground.

2 *Zuru New Zealand Ltd v Lego Juris A/S* [2023] NZHC 1808.

Start preparing for the Incorporated Societies Act 2022

At long last the Incorporated Societies Act 2022 will come into full force on Thursday, 5 October 2023, replacing its predecessor after 115 years.

Societies can re-register under the 2022 Act from this date, and must do so by 5 April 2026 or they will cease to exist.

When applying to re-register, all societies must file a new or updated constitution that complies with the new legislation.

Other key changes under the 2022 Act include:

- All societies must have a governing body
- Officer duties have been set out, and are comparable to, director duties under the Companies Act 1993
- A person must give consent to become a member of a society
- Annual general meetings must be held, and financial statements and annual returns must be filed, within six months of the society's balance date, and
- Every society must have a dispute resolution process set out in its constitution.

The Incorporated Societies Regulations were released this month. Every society should be drafting or reviewing its constitution in preparation for re-registration. Under s30(A) of the Charitable Trusts Act 1957, existing trust boards incorporated under that Act, need not re-register under the 2022 Act, but can elect to do so if they wish.

If you need a hand in doing this for your society, please don't hesitate to be in touch – we are here to help.

ESG and directors: The Companies (Directors' Duties) Amendment Act 2023 becomes law

The Companies (Directors' Duties) Amendment Act 2023 was passed on 3 August 2023 and is now in force.

The legislation clarifies that company directors may consider matters other than profit maximisation when assessing what is in the best interests of the company such as, for example, environmental, social and governance matters.

The Act has attracted criticism from, amongst others, the Ministry of Business, Innovation and Employment; the New Zealand Law Society; and the Institute of Directors, with many arguing the new legislation will have a marginal impact, if any.

In any event, it acts as a signpost to directors clarifying that profit maximisation is not the only consideration when discharging their duties to act in the best interests of the company. +

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