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Fineprint



Sources of Cash for Business

Evaluating what best suits your business needs

If you are a business owner or manager then you will typically need cash to purchase stock, plant and equipment, repay the bank or shareholders, or fund losses if things aren't going so well. Where this cash is sourced from can have a significant impact on the financial stability of your business and put the assets of the business at risk if not structured properly.

There are a number of options available for sourcing cash for your business. These include the reasonably common approach of leveraging the company's balance sheet or your personal assets (such as your family home) to raise bank finance. There are also the less common alternatives of seeking equity investment or factoring specific assets of the business through the use of invoice finance.

There is also the frequently used option to release cash from your business's trading cycle by turning over stock faster, requiring debtors to pay sooner and/or stretching out payments to creditors.

Each source has its pros and cons, and each carries business risk.

Talk with your bank

Talking to your bank manager is tough at the best of times but there's real benefit in having a strong and established relationship with the person holding the purse strings. If your business is rocketing along and making a good annual profit with a strong positive cash flow, then raising debt finance is likely to be relatively straightforward.

If things aren't going so well or your business is at an early stage of its growth cycle then the conversation may be a little trickier.

Banks are low risk lenders, offering fairly cheap interest rates and, in turn, expect a loan to be well secured and repaid in full and on time.

It's unclear at present just what impact the new loan to value ratio (LVR) restrictions on bank funding will have on small businesses and their ability to raise finance. A significant number of owners raise seed and growth capital against the equity in their homes and LVR caps may limit their ability to do this.

The chances are that if your business needs to raise serious cash from the bank, then your business will need to be a proven performer and have access to a strong asset base to stand behind it. Either that or you are going to have to have a pretty good relationship with the person at the other end of the phone.

Find an investor

If the bank doesn't come to the party or you're looking at alternatives to raise debt



finance, you may choose to issue new 'preferred' or 'ordinary' shares to raise capital.

Investors tend to be attracted to businesses that either pay a dividend or are in a high growth phase and are therefore likely to realise a significant capital gain over a reasonably short period of time.

By issuing 'preferred' shares you can retain control of the company's operations by limiting voting rights. This does tend to come at a price, however, as you may be required to pay a higher coupon rate (or fixed dividend rate). Preferential shareholders also rank ahead of ordinary shareholders if the business runs into trouble and needs to be wound up.

Selling 'ordinary' shares comes with more strings attached and could lead to real difficulties down the line if appropriate shareholder arrangements aren't put in place at the outset. If you're thinking of taking on an equity investor (whether in a passive or active capacity), we would strongly recommend that you talk with us to ensure the consequences of such a move are clearly understood.

It's also important to understand that introducing investors into your business raises a number of personal, as well as financial, considerations and should not be done lightly. Remember 'if you lie down with dogs you're sure to get up with fleas'.

Factor in a factor

Debt factoring is a quite common practice overseas (the UK and the US in particular) but doesn't seem to hold as much appeal for New Zealand business owners.

Factoring is a transaction in which a business sells its accounts receivable to a factoring agent at a discount. The business gets cash quickly and doesn't have to collect the debt. The factoring agent collects the debt and makes a profit by paying less cash than the face value of the invoice (typically around 90-95%).

Different factoring agents will have different policies and may prefer to purchase your entire debtor book, invoices relating to certain periods, amounts owing by specific customers or even a single invoice. They will generally seek to take a specific security interest (registered on the Personal Property Securities Register) over the invoices to be purchased and collected or, if available, a general security interest over all the assets and undertakings of your business.

Care should be taken here as entering into an agreement that grants a security interest will usually be an event requiring consent of your bank. Banks and other finance providers may also view factoring arrangements as a sign of financial stress on your business. This will, however, ultimately depend on the circumstances and the reasons for seeking finance in the first place.

In reality, running a successful business is all about managing cash flow and a factoring arrangement can help to speed up your cash conversion cycle by reducing the length of time that your working capital is tied up in the production and sales process before being

converted to cash through collected sales. This in turn can help provide the short-term funding required for business growth.

Where businesses tend to get into trouble is where factoring arrangements are used to collect revenue early and repay overdue accounts; this can contribute to a downward spiral. If the basic fundamentals of earn more than you spend are not supported, then factoring is not going to be a viable long term solution. It will only delay the inevitable.

Work the business harder

As an alternative to debt factoring, you may wish to focus on your business's internal efficiencies to ease the working capital requirement.

As a simple example, if your business needs \$300,000 of working capital to fund \$1 million of sales this could potentially cost you \$45,000/year in interest (applying a 15% bank overdraft interest rate).

This cost may be significantly reduced by focussing on your business's cash conversion cycle. Gains can be achieved by increasing stock turnover and reducing the total amount held on the balance sheet, negotiating more favourable terms with suppliers and/or proactively chasing debtors to reduce payment timeframes.

Using the earlier example, if you were to achieve a 20% efficiency gain then it could theoretically reduce your external borrowing requirement by \$60,000 and save \$9,000/year in interest costs. This could also ease pressure on funding limits and help improve your working relationship with the bank.

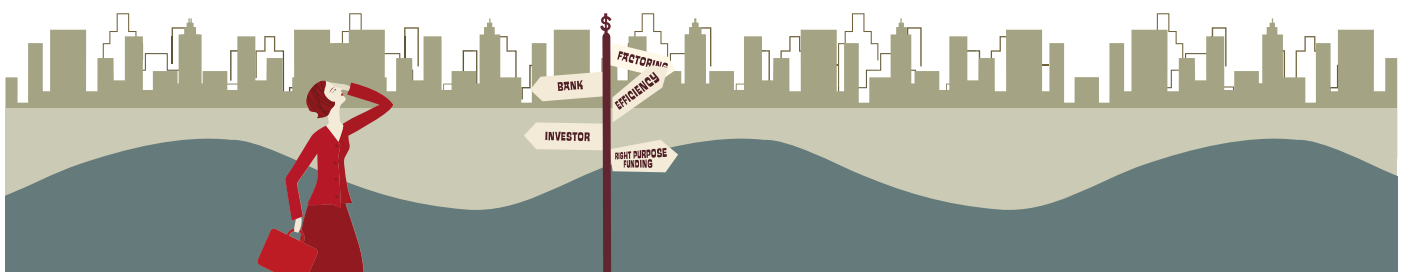
Your customers and suppliers are your cheapest source of finance and shouldn't be underestimated as a way of freeing up short term working capital. You don't want to push them too far, however, and finding the right commercial balance between getting what you want on the trade side and keeping your customers and suppliers happy is crucial. As the old saying goes 'a business with no customers is no business at all'.

The right funding for the right purpose

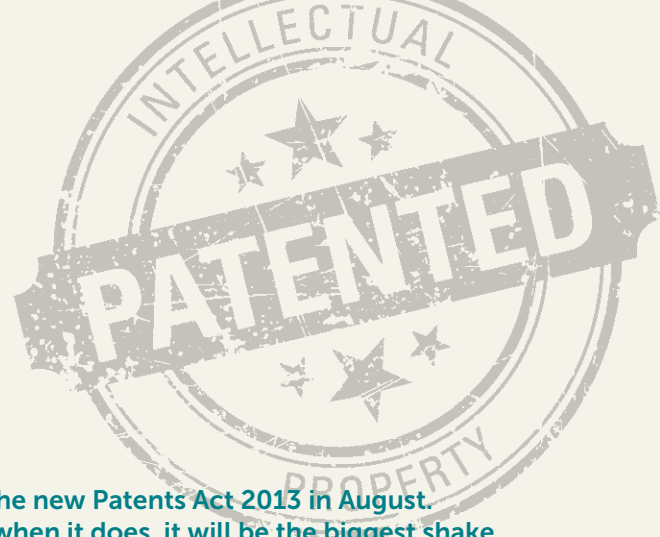
Ultimately, there are a number of ways in which your business can source funding. Critical to the success of any arrangement is your ability to access the right funding source for the right purpose.

It doesn't make a lot of sense, for example, to draw down a fixed two year term loan to provide bridging finance for a short term working capital requirement. You should also avoid using an expensive bank overdraft facility to purchase long term, income generating assets such as machinery, plant or other equipment.

If you are unsure about which type of funding best suits your business requirements, do talk to your business advisors. Your bank manager or accountant should be able to assess and advise you on the most efficient source of funding to use. And also remember to talk to us about the best way to structure the arrangements to minimise your downside risk. Better yet, talk to all three at the same time. ■



The New Patents Act



How it could affect your business

New Zealand patent law has been overhauled with the passing of the new Patents Act 2013 in August. The legislation won't come into force until sometime in 2014 but, when it does, it will be the biggest shake up in New Zealand's intellectual property landscape in more than 50 years. In this article we explain how the key changes may affect your business.

Patentability of software

The new Act will change the way that patent applications for inventions involving software will be examined. In some cases, inventions that were patentable under the current laws may be more difficult to patent under the new laws. In the short term, however, there will be some uncertainty for applicants while the boundaries of patentability are clarified. Any innovator wanting to protect their software-related innovations should get advice as to how the new laws will affect their ability to do so.

Tougher examination

At present the Intellectual Property Office of New Zealand (IPONZ) does not examine for an 'inventive step' when considering whether to allow a patent. Under the new law, IPONZ will be able to formally examine patent applications to determine whether the claims involve an inventive step over the existing products and documents.

Therefore, there will be fewer instances when companies need to go to the expense of opposing patent applications that lack inventive step. This change is a benefit to both patentees and businesses that are concerned that they may infringe other people's patents.

The new Patents Act also raises the bar on the standard to secure a grant of a patent. The new standard is whether the 'balance of probabilities' is in favour of the applicant, whereas the previous law merely required that the 'benefit of the doubt' be provided to the patentee. It's anticipated that IPONZ will try to use this new standard to justify a rigid interpretation of the inventive step requirement for a claimed invention.

Re-examination

Third parties will be able to request re-examination of a patent application or granted patent. The re-examination process will provide a cost-effective way to challenge an accepted application or granted patent. The re-examination procedures are, therefore, likely to be of significant value to New Zealand businesses.

Requesting examination

Applicants will need to actively request examination of a patent application rather than an examination occurring automatically. The deadline by which an examination must be requested after filing an application is yet to be specified. There's also likely to be an official charge associated with this requirement.

Absolute novelty

The new law will formally bring New Zealand's patent legislation into line with many overseas countries. There will be a requirement that an invention is novel when compared with information in the public domain anywhere in the world, rather than merely compared with information in the public domain in New Zealand.

Publication of applications

New Zealand public patent applications will now be published 18 months after filing. Since damages for infringement of a patent may be accrued from the date of publication, New Zealand businesses will need to be aware of published patent applications which their own activities may infringe. As a result, keeping watch on patent publications in relevant technology fields will be increasingly important under the new Act.

Transitional provisions

Patent applications filed before the law changes will continue to be examined under the current patent laws. There will be, however, some exceptions:

- If a complete specification is filed in support of the patent application after the commencement date of the new Act, and
- If the application is post-dated to a date after the commencement date of the new Act.

These provisions are important for patentees to consider when deciding how to secure protection for an invention.

We recommend that applicants file patent applications in New Zealand before the implementation of the new legislation. This will enable applicants to side-step the provisions of the new Act and the uncertainty around examination which we've noted above.

New legislation is an improvement

The new Patents Act is a significant improvement to New Zealand's patent laws and will significantly benefit patentees and New Zealand businesses as a whole.

The new Act will, however, require some bedding in once it comes into force. It's anticipated that there will be a period of uncertainty for applicants as IPONZ grapples with the new issues that it must consider during examination.

We will keep you up to date with the implementation of this new legislation, and of the yet-to-be-drafted Regulations. In the meantime, if you'd like to know more about the impact on your business of this new legislation, please be in touch. ■

Door-to-Door Salespeople

Protecting yourself

The emergence of the so called 'bitumen bandits', consisting of mainly foreign groups of men who target vulnerable people by posing as legitimate traders, has highlighted the need for everyone to be vigilant when confronted with door-to-door salespeople. The good news is that door-to-door sellers, like any other sellers, must be honest about the goods and services they sell.

What is a door-to-door sale?

A door-to-door sale is when goods or services are sold at a place other than the usual trade premises of the seller. The obvious case is when a seller calls in at your home to sell you goods or services. It's possible, however, that some transactions entered into online will also be considered a door-to-door sale.

The law

While the Fair Trading Act 1986 and the Consumer Guarantees Act 1993 may apply to how these people do business, the current legislation covering door-to-door sales is the Door to Door Sales Act 1967. The legislation is due to receive an upgrade to give consumers greater protection by being incorporated in the Consumer Law Reform Bill. Before the new legislation is enacted, however, the 1967 Act is what's in place at the moment.

Protecting yourself

The first means of protecting yourself is to know what you're protected from and what you aren't. You're protected by the Act if the seller makes the first approach to you and a credit sale takes place. A credit sale is one where you pay after the goods or service is received. This means that if you pay cash up front, you aren't covered by the legislation.

If you're buying goods or services on credit from a door-to-door sales person, make sure you obtain a written agreement; this must be signed by both you and the seller. Ensure that the agreement shows the name and address of the trader, the cash price, the amount of each payment and – if it's appropriate – how many, how often and where payments are to be made.

Make sure you're given a copy of the agreement, which should have a notice about your right to cancel. Make sure you understand the agreement or ask someone to explain it to you, particularly the total amount of money you must pay. Don't sign until you've had time to do this, no matter how much the salesperson encourages you to sign then and there on the doorstep.

Other things to be aware of and are good practice to use when there's a salesperson on your doorstep, include asking for identification, obtaining and comparing quotes from other providers and getting the seller's references and contact details.

Cancelling the agreement

If you decide you don't want the goods or service, you have seven days to cancel the agreement. The seven days starts the day after the date the credit agreement was made. Cancelling the agreement means that the salesperson or, more usually, the company supplying the goods, must return any money you've paid. You're also entitled to retain the goods already received until you get your money back.

In some cases, you may have up to one month to cancel the agreement, starting the day after the date that you agreed to buy. You'll be able to do this only if the agreement isn't signed by either you or the seller, it doesn't contain adequate details about the trader or purchase, you weren't given a copy of the agreement, or you didn't receive a Right to Cancel form or Notice of Cancellation. If cancelled, the agreement is treated as if it never had any effect.

You're entitled to keep the goods until you get your money back and it's not your responsibility to take any cancelled goods back to the seller; the seller must pick them up from you. You do have an obligation, however to take reasonable care of any goods for 21 days after you give notice of cancellation. It's also handy to know that if the seller has provided any services before you cancel the contract, the seller is not entitled to any compensation for those services.

Go with your instinct

Decisions made on the spot with a door-to-door sale are often those that you may come to regret later. In order to avoid this, give yourself time to consider both whether you want to go ahead with the purchase and whether the person standing in front of you is legitimate. If it doesn't feel right, then it probably isn't. ■



Animal Welfare

Caring for your herd or your family pet

Caring for animals is a moral obligation for us all, or is it? Whether you are responsible for a farm full of animals or have a family pet, you have legal responsibilities towards them.

Animal welfare is protected by our Animal Welfare Act 1999. This legislation provides that the owner or person in charge of an animal is responsible for:

- Its physical health and behavioural needs
- Treating or humanely putting down sick or injured animals
- Ensuring animals are not kept in pain or distress or sold in this condition, unless the sale is for the purpose of the animal being put down
- Not deserting an animal without making provision for its needs
- Not ill-treating or killing an animal such that it feels pain or distress, and
- Ensuring that animals are fit to be transported.

Codes of Welfare

Administered by the newly established Ministry of Primary Industries (MPI), the Act provides for Codes of Welfare to be developed which provide minimum standards of care and also provide recommendations for best practice. These Codes include guidelines for the care of animals for circuses, zoos, companion animals such as cats and dogs, through to sheep and beef cattle, dairy cows and pigs. You can find out more about the Codes on the MPI's website, www.mpi.govt.nz

Farm animal welfare is administered primarily by the MPI's animal welfare Inspectors; companion and domestic animals in urban areas are covered primarily by the SPCA.

Vets also have some obligations under the Veterinary Council of New Zealand Code of Professional Conduct and therefore vets are very active in promoting and monitoring animal welfare. Often vets will deal directly with the animals' owners when they are confronted with situations they may find in the course of their practice, with very successful outcomes¹.

Animal welfare inspectors have the ability to:

- Enter land, premises and vehicles to inspect animals
- Stop vehicles and seize animals, and
- Take steps to prevent or mitigate suffering of animals, including the right to destroy animals that are injured and/or sick.

If you're concerned about any aspects of animal welfare get in touch with the MPI or your local vet clinic enabling those who are statutorily responsible for animal welfare to address these issues.

Dealing with complaints

Currently once complaints are assessed, the animal's welfare may warrant inspection either immediately or in the next couple of days to assess the actual situation and to decide if a formal action plan needs to be put in place to secure the affected animals' welfare. Welfare issues may underlie serious and ongoing issues in relation to animal ownership. Early identification of any concerns, however, will ensure that the situation can be readily addressed with minimal suffering for those animals.

Worst case outcomes can result in the destruction of animals and criminal charges being laid. The penalties under the Animal Welfare Amendment Act 2012 are "in the case of an individual, to imprisonment for a term not exceeding 12 months or to a fine not exceeding \$50,000 or to both; or in the case of a body corporate to a fine not exceeding \$250,000."²

It's important to remember that 'animals are sentient – they can feel pain and distress – and as a humane society we have responsibilities to ensure our animals' needs are met.'³ ■

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1 The Veterinarians Animal Welfare Toolkit (The New Zealand Veterinary Association and MAF)

2 S4, Animal Welfare Amendment Act 2012

3 New Zealand Animal Welfare Strategy (Ministry for Primary Industries, May 2013, Page 3)

Postscript

Employment law update

Employers cannot deduct compulsory KiwiSaver from those on the minimum wage:

A recent Court of Appeal decision⁴ has confirmed that compulsory employer KiwiSaver contributions cannot be deducted from the minimum wage paid to employees. This decision upheld an Employment Court decision that said the purpose of the minimum wage was to ensure workers received base wages to allow them to meet living expenses. A component of savings for retirement was not built into the minimum wage.

No offsetting high and low season wages: More on the minimum wage ... the Employment Relations Authority recently ruled that employers cannot average out weekly pay over a season. There can be no offsetting high season wages against wages paid in the low season.

Any salary package must be at least at the level of the minimum wage, currently \$13.75/hour. If you have an employee paid on a daily rate, the minimum is \$110/day and \$13.75/hour for each hour exceeding eight hours worked that day. On a weekly basis, the minimum is \$550/week and \$13.75/hour for each hour exceeding 40 hours worked by your employee that week.

We remind all employers that you must keep accurate and timely records for all your employees' wages. ■

New tax deduction law for bach owners

With the holiday season almost upon us, bach owners might want to study up about the relevant changes to the rather bizarrely-named Taxation (Livestock Valuation, Assets Expenditure and Remedial Matters) Act that came into force on 17 July 2013.

This legislation tightens the rules around deducting expenses related to assets that are used privately by the owner and also used to earn income. Holiday homes, boats, yachts and aircraft – mixed use assets – all come under this IRD net.

Simply put, under the new legislation expenses relating to both private and paid use of the asset (such as rates and electricity) will be apportioned using a new formula. There's an additional requirement that owners need to earn at least 2% of the property's Rateable Value in any given tax year if they want to claim expenses in excess of income derived from the asset.

This legislation applied to bach owners from 17 July 2013. Owners of other mixed use assets such as aircraft, boats and yachts have a reprieve until the tax year ending 31 March 2015.

To find out more on how this legislation may affect you, go to: <http://www.ird.govt.nz/business-income-tax/expenses/holiday-homes/> ■

Trust law to be overhauled

As you may be aware, the Law Commission published its review on trusts in September. The Commission has recommended changes to the legislation dealing with trusts including giving courts the ability to order the transfer of trust assets to compensate disadvantaged partners following marriage or other relationship breakdowns.

Law Commission President, Sir Grant Hammond, said it was in the public interest "to have a modern statute that gives trustees and others guidance as to how a trust is to be managed and increases the accountability of trustees".

We will keep you abreast of developments. ■



BREADEN
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LAWYERS

PARTNERS

Don Breaden
John McCardle
Stephen Chubb
Graham Mowbray

CONSULTANTS

Alf Fairbairn
Peter Quinn

ASSOCIATES

Nikki Coulston
Fiona Green

SOLICITOR

Sophie Kinsella

LEGAL EXECUTIVES

Roz Glover
Libby Spiers
Greg McCardle
Robyn Burch

GENERAL MANAGER

Mark Kennedy

www.bmc-law.co.nz

44C Ihakara Street
Paraparaumu
PO Box 140
Paraparaumu 5254

T 04 296 1105
F 04 297 3231
E info@bmc-law.co.nz

⁴ Terranova Homes and Care Limited v Fitalia [2013] NZCA 435 (19 September 2013)