A DIRECTOR BY ANY OTHER NAME
Duties of Board and Committee Members of Religious Institutions

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1 INTRODUCTION

1.1 Depending on the structure of a religious institution, its governors may carry different titles (for example, board of directors, committee members, council members, elders, trustees, etc).

1.2 However, no matter which name they bear or what structure of entity they govern, a religious institution's governors bear duties which they must property discharge. These obligations may spring from statute, but are underpinned by common law principles and may be enforced at common law. An examination of the various sources of the duties reveals four broad duties that generally apply to governors across all charitable entities regardless of structure (perhaps only with the exception os some unincorporated associations), and regardless of whether the governors are called 'Directors' or another name:

1.1.1. Duty of care, skill and diligence;

1.1.2. Duty of good faith and proper purpose;

1.1.3. Duty to avoid conflicts of interest; and

1.1.4. Duty not to improperly use position or information.

1.3 Our practice in this area of law indicates that whilst many religious institutions have been managed with high attention to development of good governance culture for many years, conversely some religious institutions (and particularly those which are unincorporated in their structure) may have allowed governance concerns to perpetually go unaddressed. In particular, the following attitudes have at times appeared (although, thankfully, very rarely in recent years):

1.3.1 A belief that governors following God's calling for the institution will be afforded God's protection;

1.3.2 A belief that governors acting on a volunteer basis will not be called to account over governance matters.

1.4 These attitudes are no longer defensible in the changing face of governance expectations across the charitable sector in Australia generally, including for religious institutions.

1.5 At the outset, we acknowledge the significant liability exposure for religious organization governors for breach of duty of care arising out of historical sexual abuse allegations. This paper deals with governance duties only, and it is therefore beyond the scope of this paper to make comment about the potential liability for governors that may arise our of such allegations (although we understand this will be considered at another session of this conference).

The meaning of 'not-for-profit' and ATO Governance obligations

1.6 A critical starting point for our examination of governor's duties in the context of religious institutions is an understanding of the not-for-profit nature of such institutions, given the tax concession charity status that is available to religious institutions registered as charities.

1.7 The meaning of 'not-for-profit' in the context of the ACNC regulatory regime has no statutory definition, but rather is a 'term of art' that takes its meaning from judicial authority.

1.8 Guidance published by the ACNC on the meaning of 'not-for-profit' has recently received some judicial approval in the recent South Australian case of *Re The Lutheran Laypeople's League of Australia Inc*.[1] That regulatory guidance is as follows:

> "Generally, a not-for-profit is an organisation that does not operate for the profit, personal gain or other benefit of particular people (for example, its members, the people who run it or their friends or relatives)… Not-for-profits can make profit, but any profit made must be applied for the organisation's purpose(s)".[2]

1.9 It should be noted that the ATO has published very similar (but slightly different) regulatory guidance on the meaning of 'not-for-profit' it approves. That regulatory guidance is as follows:

> "A not-for-profit (NFP) organisation does not operate for the profit or gain of its individual members, whether these gains would have been direct or indirect. This applies both while the organisation is operating and when it winds up. An NFP organisation is not an organisation that hasn't made a profit. An NFP organisation can still make a profit, but this profit must be used to carry out its purposes and must not be distributed to owners, members or other private people."[3]

1.10 In addition, the *Income Tax Assessment Act 1997* (Cth) imposes the following obligations in section 50-50(2) on charities enjoying tax concessions (emphasis added):

> (2) The entity must:
>
> (a) **comply with all the substantive requirements in its governing rules**; and
>
> (b) apply its income and assets **solely for the purpose for which the entity is established**.

1.11 The ATO's regulatory approach in relation to the 'solely' requirement receives greater explanation in Taxation Ruling 2015/1. That Ruling states:

> "The income and assets condition requires an entity to apply its income and assets 'solely' for the purpose for which the entity is established. This means that the entity must exclusively or only apply is income and assets for that purpose. **A strict standard of compliance is required under the 'solely test'**."[4]

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[1] [2016] SASC 106 (11 July 2016).

[2] Australian Government, The Australian Charities and Not-for-profits Commission, Register my Charity.

[3] Australian Government, Australian Taxation Office, Is your organisation not-for-profit? (20 July 2015).

[4] Taxation Ruling 2015/1: Income tax: special conditions for various entities whose ordinary and statutory income ix exempt, paragraphs 33-34.

2 SOURCES OF THE DUTIES

2.1 Confusion may arise due to the various sources of a charity governor's duties, which may spring from a number of legislative sources depending on the structure of the institution in addition to the common law. Legislative sources of the duties have effectively codified the common law in relation to the duties (fiduciary and otherwise) of governors.

2.2 A summary of the duties at each source is set out below.

Corporations Act 2001 (Cth)

2.3 The most common understanding of 'Directors Duties' is drawn from the relevant provisions of the *Corporations Act 2001* (Cth) ("CA"). The duties set out in that statute can be summarised as follows:

2.3.1 The duty to act with care, skill and diligence - section 180;

2.3.2 The duty to act in good faith and for a proper purpose - section 181;

2.3.3 The duty not to improperly use position or information - section 182;

2.3.4 The duty to avoid and manage conflicts of interest - section 191.

ACNC Governance Standards + External Conduct Standards

2.4 For charities registered with the ACNC, the duties of charities directors are effectively 'turned off' - ie. the relevant sections of the Corporations Act which set out the director's duties do not apply to ACNC registered charities. In their place, the ACNC introduced its Governance Standards, as set out in the *Australian Charities and Not-for-profits Commission Regulation 2013*.

2.5 The Governance Standards are as follows:

2.5.1 **Governance Standard 1: Purpose and not-for-profit nature**[5]

2.5.2 **Governance Standard 2: Accountability to Members**[6]

2.5.3 **Governance Standard 3: Compliance with Australian laws**[7]

2.5.4 **Governance Standard 4: Suitability of Responsible Persons**[8]

2.5.5 **Governance Standard 5: Duties of Responsible Persons**[9]

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[5] *Australian Charities and Not-for-profits Commission Regulation 2013* (Cth), Regulation 45.5.
[6] *Australian Charities and Not-for-profits Commission Regulation 2013* (Cth), Regulation 45.10.
[7] *Australian Charities and Not-for-profits Commission Regulation 2013* (Cth), Regulation 45.15.
[8] *Australian Charities and Not-for-profits Commission Regulation 2013* (Cth), Regulation 45.20.
[9] *Australian Charities and Not-for-profits Commission Regulation 2013* (Cth), Regulation 45.25.

2.6 Governance Standard 5 deals with governors' duties most predominantly, but the compliance obligation is on the charity to take reasonable steps to ensure its governors are subject to and comply the duties (rather than on the governors themselves).

2.7 The most recent ACNC Compliance report[10] indicates that almost one-third of its compliance activity in the relevant year was to do with compliance with Governance Standard 5.

2.8 The objects of Governance Standard 5 set a clear expectation that governors of registered charities are to conduct themselves in a manner that would be necessary if the relationship between them and the registered entity was a fiduciary relationship (thus obliging them to satisfy minimum standards of behavior consistent with that relationship).[11]

2.9 Governance Standard 5 states as follows:

Governance standard 5--Duties of responsible entities (emphasis added)

Standard

(2) A registered entity must take reasonable steps to ensure that its responsible entities are subject to, and comply with, the following duties:

a. to exercise the responsible entity's powers and discharge the responsible entity's duties with the degree of care and diligence that a reasonable individual would exercise if they were a responsible entity of the registered entity;

b. to act in good faith in the registered entity's best interests, and to further the purposes of the registered entity;

c. not to misuse the responsible entity's position;

d. not to misuse information obtained in the performance of the responsible entity's duties as a responsible entity of the registered entity;

e. to disclose perceived or actual material conflicts of interest of the responsible entity;

Note: A perceived or actual material conflict of interest that must be disclosed includes a related party transaction.

f. to ensure that the registered entity's financial affairs are managed in a responsible manner;

g. not to allow the registered entity to operate while insolvent.

2.10 The External Conduct Standards (which commenced in this last week of July 2019) impose obligations on a charity that the governors will need to consider in the proper discharge of their duties (whether they are a Basis Religious Charity or not). In short, those standards are:

2.10.1 **Standard 1 – activities and control of resources (including funds);**

2.10.2 **Standard 2 – annual review of overseas activities and record-keeping;**

2.10.3 **Standard 3 – anti-fraud and anti-corruption;**

[10] https://www.acnc.gov.au/tools/reports/compliance-report

[11] *Australian Charities and Not-for-profits Commission Regulation 2013* (Cth), Regulation 45:25(1).

2.10.4 **Standard 4 – protection of vulnerable individuals.**

2.11 While the ACNC External Conduct Standards are not directly imposed on governors, there are potential adverse sanctions for governors of federally regulated entities available to the ACNC in relation to a breach of the Standards.

Unincorporated Associations

2.12 Determining the duties that apply to the governors of a religious institution structured as an unincorporated association is more ambiguous than any other structure.

2.13 It should of course be remembered that Basic Religious Charities are not currently subject to the ACNC Governance Standards (but are subject to the External Conduct Standards).

2.14 The starting point is that the obligations of committee members at common law are scant, and unlike companies limited by guarantee (covered by the Corporations Act or ACNC governance standards), or incorporated associations (covered by relevant stat legislation and/or the ACNC governance standards):

> "An unincorporated association is not recognised as a separate legal entity to its members - it is a group of people who have come together to pursue a common purpose. Unincorporated associations are not specifically regulated by state or territory legislation, so management committee members of these associations have no legislative obligations towards the association. **Management committee members also owe no general law obligations towards the association.** Therefore, unless some duties are already included in an unincorporated association's governing rules, management committee members should take reasonable steps to ensure that they are subject to and comply with the duties under Standard 5".[12]

2.15 However, this is not the end of the story for unincorporated associations. We note the following:

2.15.1 The ACNC governance standards will apply if the unincorporated association is registered with the ACNC and does not qualify as a basic religious charity.[13]

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[12] I Ramsay and M Webster, 'Registered charities and governance standard 5: An evaluation' (2017) 45 Australian Business Law Review 127-158at [3.4].

[13] [13] *Australian Charities and Not-for-profits Commission Act 2012* (Cth), section 205-35. - An entity is a basic religious charity if:

1. The entity is registered as a charity with the ACNC with the subtype of "advancing religion";
2. The entity is not entitled to be registered under any other charitable subtype;
3. The entity is not a body corporate or incorporated association (ie. t*he entity is structured as an unincorporated association*);
4. The entity is not a deductible gift recipient;
5. The entity does not report to the ACNC as part of a reporting group; and
6. The entity does not receive grants from Australian government agencies exceeding $100,000 in any financial year.

2.15.2 Governors duties may be imposed on committee members by virtue of the association's governing rules – given that members of a management committee for an unincorporated association will almost certainly also be members of that association, and "admission to membership carries with it an obligation to confirm to the rules of the association" – see further comments below from paragraph 2.17;[14]

2.15.3 Obligations to ATO under section 50:50(2) - an unincorporated association must comply with all the substantive requirements in its governing rules, and apply its income and assets solely for the purpose for which the entity is established to remain eligible for charity tax concessions;

2.15.4 The External Conduct Standards may apply to the charity, to the extent that it operates outside of Australia;

2.15.5 Even though common law obligations cannot be applied to an "association" that has no legal identity, these obligations may arguably apply at the suit of fellow Management Committee members (and potentially to the members of the association).

2.16 Best practice would suggest that unincorporated association governors should seek to substantially comply with Governance Standard 5, regardless of whether they are a Basic Religious Charity or not.

Unincorporated Association rules – binding, or 'consensual compact'?

2.17 Governing rules or constitutions of an unincorporated association particularly in the context of Religious Unincorporated Associations have been described by the courts as a 'consensual compact – that is, rules established on a consensual basis but not amounting to an enforceable contract unless there are clear indications that the members intended to create legal obligations capable of enforcement.[15]

2.18 In the case of *Scandrett v Dowling*, the New South Wales Court of Appeal considered the legal effect of the constitution of the Anglican Church (an unincorporated association), and concluded that "the basis of the consensual compact or contract thus must be a willingness to be bound to it because of shared faith… based on religious spiritual and mystical ideas, not on common law contract".[16] However, the Court went further to suggest that the governing rules can have the "same effect as a common law contract when matters of church property become involved with the other matters dealt with by the consensual compact" – and therefore, at least some of a consensual compact's rules are capable of legal enforcement.[17]

2.19 The principles espoused in *Scandrett v Dowling* were relied upon by the Supreme Court of South Australia in the matter of Harrington & Ors v Coote & Anor,[18] in which the Court was

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[14] Keith Fletcher, The Law Relating to Non-Profit Association in Australia and New Zealand (1986) The Law Book Co., Sydney, p.61

[15] Cameron v Hogan [1934] HCA 24; (1934) 51 CLR 358, 371.

[16] (1992) 27 NSWLR 483, 527 and 554.

[17] Ibid, 554.

[18] [2013] SASCFC 154

required to consider the justifiability of a matter concerning the internal affairs of an Anglican Church diocese in South Australia which had sought to enforce its Professional Standards Ordinance against a licensed priest of the Anglican Church accused of sexual misconduct.

2.20 Alongside the rules under consideration, section 3 of the *Anglican Church of Australia Constitution Act 1961* (SA) ("ACAC Act") provided that the constitution, canons and rules of the Church in South Australia are binding on bishops, clergy and laity of the Church in South Australia in matters relating to property.

2.21 In that case, it was held in the majority judgment that the right to appoint a member of clergy to a position with a "benefice or salary", and the licence held by a member of the clergy to conduct spiritual ceremonies on the property of the church, were both "matters of property" enforceable under the unincorporated association's governing rules.[19]

2.22 In the judgment of Gray J, he went further to suggest that *even if section 3 of the ACAC Act did not exist*, the matters for consideration in the case would have been justifiable by the Court:

> "It may be concluded that the Anglican Church of Australia is a voluntary association bound together by a consensual company, that the rights of its members *inter se* depend on the terms and conditions of the company, and that the terms and conditions constitute a contract in which eery member is bound to the whole body and to every other member to act in accordance with its provisions. Had it been necessary to do so, the Court's jurisdiction would have been enlivened..."[20]

2.23 This decision, and other authorities it refers to in extensive detail, suggest that the Court's willingness to intervene in matters relating to the management of unincorporated associations is not so hesitant as generally believed. Where a matter concerns proprietary interests of the association (and in our view, matters involving the proper discharge of governors duties are likely to frequently effect the proprietary interests of the association), the Court may be willing to intervene and enforce the association's rules to the extent that they impose duties and obligations on the association's governors. Query: Would common law duties be impaired when proprietary interest were concerned?

Incorporated Associations:

2.24 Most (but not all) states and territories have legislation which sets out the relevant duties of management committee members of incorporated associations. However, where the state and territory laws do not set out duties for governors of incorporated associations that are substantially the same or otherwise adopt the content of Governance Standard 5, a registered charity must take reasonable steps to ensure that its governors comply with any Governance Standard 5 duties that are not adequately addressed by the legislation.[21] Effectively therefore, Governance Standard 5 applies to the extent of any inconsistency with duties imposed by the relevant state and territory legislation.

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[19] Ibid at 21.

[20] Ibid at 140.

[21] *Australian Charities and Not-for-profits Commission Regulation 2013 (Cth), s 45.130(4).* See also*, Explanatory Statement, Australian Charities and Not-for-profits Commission Amendment Regulation 2013 (No 1) (Cth) 16.*

2.25 In summary, we adopt the table prepared by Ian Ramsay and Miranda Webster in their 2017 paper "Registered Charities and Governance Standard 5: An Evaluation" published in the *Australian Business Law Review* which sets out the analogous statutory duties for each of the duties imposed on charity governors by Governance Standard 5:

Source of law	Australian Charities and Not-for-Profits Commission Regulation 2013 (Cth)	Associations Incorporation Act 1991 (ACT); Associations Incorporation Act 2009 (NSW); Associations Act (NT); Associations Incorporation Act 1981 (QLD); Associations Incorporation Act 1985 (SA); Associations Incorporation Act 1964 (TAS); Associations Incorporation Reform Act 2012 (VIC); Associations Incorporation Act 2015 (WA)
Regulator/Enforcer	ACNC	Office of Regulatory Services (ACT); Office of Fair Trading (NSW); Department of the Attorney-General and Justice (NT); Office of Fair Trading (QLD); Consumer and Business Affairs (SA); Consumer Affairs and Fair Trading (TAS); Consumer Affairs Victoria; Department of Commerce (WA).
Duty to act with reasonable care and diligence	s 45.25(2)(a)	NSW s 30A; SA s 39A(4); VIC s 84; WA s 44(1).
Duty to avoid insolvent trading	s 45.25(2)(g)	NSW s 68 (criminal); SA s 49AD (criminal); VIC s 152; WA s 127 (criminal).
Duty to ensure responsible management of financial affairs	s 45.25(2)(f)	While the state and territory legislation may not directly impose a duty on committee members to ensure the responsible management of the financial affairs of the association, the legislation may set out requirements (such as for the managment of funds) which could shape the association's obligation under Standard 5. See, for example, *Associations Incorporation Regulation 2016* (NSW) ss38-40.
Duties to act in good faith in the best interests of the association and for a proper purpose	s 45.25(2)(b)	VIC s 85; WA s 45.

Duty not to misuse information	s 45.25(2)(d)	NSW s 32 (criminal); NT s 33(2); SA s 39A(2); VIC s 83; WA s 47.
Duty not to misuse position	s 45.25(2)(c)	NSW s 33 (criminal); NT s 33(3); SA s 39A(3); VIC s 83; WA s 46.
Duty to disclose a conflict of interest	s 45.25(2)(e)	Disclosure: ACT s 65(1); NSW ss 31(1)-(4); NT s 31; SA s 31; VIC s 80; WA s 42. Restrictions on deliberation and voting: ACT s 65(2); NSW ss 31(5)-(6); NT s 32; SA s 32; VIC s 81; WA s 43.

2.26 In addition to the duties imposed by state-based legislation or the ACNC Governance Standards, members of a management committee of an incorporated association may be regarded as having a fiduciary relationship with the association giving rise to common law duties to the body corporate itself.[22] Whilst the case law on this issue is minimal, extensive academic commentary suggests that the application of common law duties to committee members is 'probable'.[23]

2.27 We also note the comments of Johnson J in the matter of *Lai v Tiao (No 2)*:

> "It has been said that, in relation to an association, the committee members are in the same position as a director toward a company. It has also been suggested, although the principle is not established by authority, that it is probable that committee members owe in the same measure, the common law and equitable duties which law and equity have imposed on company directors".[24]

2.28 The conservative position is to assume that the common law duties will apply to committee members of incorporated associations.

Charitable Trustee duties

2.29 The duties of charitable trustees are not as clearly articulated as those imposed on company

[22] See comments of Owen J in Haselhurst v Wright (1991) 4 ASR 527. An incorporated association is a body corporate with perpetual succession. See also Weinert, K, Legal duties as part of the governance framework for incorporated associations: a comparative analysis (2014) 29 Australian Journal of Corporate Law 39 at 60.

[23] See, for example, Ramsay & Webster p.20 and Charles Parkinson, 'Duties of Committee Members under the Associations Incorporations Acts' (2004) 30 *Monash University Law Review* 75, 79-81.

[24] [2009] WASC 22, [84].

directors in the Corporations Act, or indeed ACNC Governance Standard 5. This is an area governed by both the State-based trusts legislation and a broad body of case law. Generally, the same duties apply to charity trustees as to trustees of private trusts - however, unlike a private trust where these duties are owed to individual beneficiaries, the trustee of a charitable trust owes their duty to the promotion of the charitable objects of the trust and to not act in breach of the terms of trust.[25]

2.30 While the duties imposed on trustees are not identical to those owed by governors of incorporated bodies, there are clear similarities.[26]

The Corporations Act turned-off debate

2.31 In our view it is an unproductive moot point to dwell on whether some of the Directors duties under the CA, have been effectively turned off by the ACNC legislation or whether they still all apply to the directors personally. We say unproductive, as even if they have been turned-off, in our view there are substantially at least equivalent duties that will arise in every State and Territory:

1.1.5. By the charity requiring compliance with the ACNC Governance Standards;

1.1.6. By the State and Territory based incorporated association legislation (if that is the type of entity);

1.1.7. At common law and equity.

2.32 Directors of entities registered under the CA are subject to Directors' duties in the CA (to the extent that they are not "turned off" – note that trustee companies of charitable trusts are not usually registered as charities in their own right [as it is the trust which holds the charitable registration] and would be subject to the entire range of directors' duties under the CA in respect of their directorship of the company, as well as the obligations imposed on them as a governor of a charity in respect of the trust).

2.33 Trustees of charitable trusts (personally or as directors of a trustee company) will have duties under the instrument of Trust and under state based trust legislation.

Common Law & Equitable Governance Duties

2.34 While many of the statutory duties of directors under the CA are effectively "turned off" for charities, and replaced by the ACNC Governance Standards, the duties at common law are not turned off.

2.35 Common law duties can be grouped into two categories, each of which have sub-categories as follows:

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[25] Dal Pont, *Law of Charity* (2nd Edition, 2017) LexisNexis Butterworths, Sydney at [17.25].

[26] Dal Pont at [17.72].

1.1.8. ***Care and diligence***

a. Duty to act with reasonable care and diligence.

1.1.9. ***Loyalty and good faith***

a. Duty to retain discretions (ie. to remain independent, and free to make decisions for the entity);

b. Duty to avoid conflicts of interest;

c. Duty to act in good faith in the best interests of the entity; and

d. Duty to use power for a proper purpose.

2.36 The above common law duties are said to be owed both at common law and equity, with loyalty and good faith being fiduciary in nature and duty of care being non-fiduciary.[27]

2.37 Justice Young put fiduciary duty in this way in a recent NSW Supreme Court decision:

> It should be pointed out that fiduciary duties owed by directors or members of a corporation not aimed at making commercial gain are different from fiduciary duties that exist in the case of an ordinary corporation. With the ordinary corporation formed for gain, it is quite clear that the fiduciary duty will extend not to act in self interest so as to deprive minority members of their property. However, where the corporation is formed otherwise than for gain, that particular aspect of the fiduciary duty may be of minimal importance. There is still a fiduciary duty. This is because the director and sometimes a member in the majority, has an obligation to use his or her power and/or property for the benefit of another. … Although the incorporated committee will, at law, own the whole of the property and there is no beneficiary as there would be in the case of a trust, the members of the committee will still have a fiduciary obligation to use the property vested in it in its corporate capacity to effectuate the purpose for which the corporation was brought into being. Thus although the property is not held on trust, the members of the committee and the committee as a corporation will have a fiduciary obligation to use the property to effectuate the purpose.[28]

2.38 While differences may arise in the application of the law of equity and fiduciary obligations to the general common law, it is not practical for the purpose of this paper to consider those distinctions. For governors, it is simply important to note that these duties exist and apply.

2.39 The balance of this paper will examine each of the broad duties in turn, and the application of each duty in the context of a charitable organisation and religious institution in particular.

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[27] Ford, Austin and Ramsay's *Principles of Corporations Law* (Lexis Nexis Australia, 2016), as cited in Ramsay and Websters' ,*Registered Charities and Governance Standard 5: An Evaluation* (2017) 45 ABLR 127.
[28] *Re Theatre Freeholds Ltd* an un reported judgement of the Supreme Court of NSW Equity Division on 12 June 1996.

3 DUTY OF CARE, SKILL AND DILIGENCE

Statutory sources

3.1 The CA provides that a director or other officer of a corporation must discharge their duties will the degree of care and diligence that a ***reasonable person*** would exercise if they were a director of a corporation in the corporation's circumstances, and occupied the same office/had the same responsibilities within the corporation as that director.[29]

3.2 The analogous requirement under Governance Standard 5 states that a registered charity must take reasonable steps to ensure that its governor exercise their powers and discharge their duties "with the degree of care and diligence that a reasonable individual would exercise" if they were a governor of the registered charity.[30]

3.3 ***Duty to prevent insolvent trading;***

3.3.1 The duty to prevent insolvent trading may be considered an extension of the general duty of care, skill and diligence despite being separately provided for.

3.3.2 In particular, section 588G of the Corporations Act imposes this duty on company directors, and we note that this duty is not switched off for ACNC registered corporate entities.

3.3.3 The CA lifts the corporate veil by imposing upon directors a duty to prevent insolvent trading; it holds them personally liable for company debts incurred while the company is insolvent.

Duty of care, skill and diligence at common law

3.4 At common law, the duty has been established that governors must act with reasonable care and diligence. This requires that they have a requisite level of skill, take a requisite level of reasonable care, and exercise a reasonable level of diligence.

3.5 ***Duty of reasonable care and diligence***

3.5.1 The standard of care expected in each case remains an objective matter based on all the facts and circumstances of the organisation itself. The following comments from a recent Federal Court case (in relation to the statutory duty under the CA) provide a helpful summary:

> "If directors act within their powers, if they act with such care as is reasonably to be expected of them, having regard to their knowledge and experience, and if they act honestly for the benefit of the company they represent, they discharge both their equitable as well as their legal duty to the company… The amount of care to be taken is difficult to define, but it is plain that the directors are not liable for all the mistakes

[29] Section 180(a), *Corporations Act 2001* (Cth).

[30] Section 45:25(2)(a), *Australian Charities and Not-for-profits Commission Regulation 2013* (Cth)

> they may make, although if they had taken more care they might have avoided them: see Ocerend, Gurney & Co v Gibb. Their negligence must not be the omission to take all possible care; it must be must more blameable than that: it must be in a business sense culpable or gross. I do not know how better to describe it".[31]

3.5.2 The extent of the duty will "depend on the size of the company and whether they are full-time senior managers or non-executive directors".[32]

3.5.3 The standard at common law reflects this position – a consideration of the nature of the position held by the director, the tasks and responsibilities actually undertaken by the director and the size and complexity of the company are relevant to determining the appropriate standard in any given case.[33]

> "The statements as regards standards and expectations of the various types of officers are of broad principle and act merely as signposts in the search for the determination of the ambit of the duties imposed on a particular director and the particular standard of care required to be met".[34]

3.5.4 The duty is heightened if conflicts of interest are involved in a particular set of circumstances. In such circumstances special vigilance is required.[35]

Do all Directors need to be able to understand financial statements?

3.6 In the Federal Court care of *ASIC v Healy*[36] (also known as the Centro Case), the Court found that eight Directors breached their duties of care and diligence when they approved incorrect financial reports. We note that this case considers the statutory duty of care under the CA section 180 – however, as commented by Middleton J in his judgment, "the Statutory duty imposed by s 180(1) reflects, and to some extent refines, that which applies at general law".[37] The judgment stated that (emphasis added):

3.6.1

> [566] Part of ASIC's case is that the apparent errors were so obvious that it can more readily be inferred that it was negligent for the directors to have failed to detect them. After all, each director was intelligent and sufficiently financially literate, having many years of experience analysing financial statements. Further, the year 2007 was not the first time each director had to read and understand accounts, even with the change in accounting standards.

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[31] Australian Securities and Investments Commission v Massimatis (no 8) [2016] FCA 1023

[32] Austin & Ramsay's Principles of Corporate Law para 8.305.9, citing Rodger J in AWA v Daniels (trading as Deloitte, Haskins & Sells) (1992) 7 ACSR 759. This is also reflected in the Explanatory Memorandum to *Corporate Law Reform Act 1992* (Cth). This is also supported by Brereton J in the decision of ASIC v Maxwell (2006) 59 ACSR 373 at 397.

[33] Halsbury's Laws of Australia, 120-7430.

[34] Vrisakis v Australian Securities Commission (1993) 9 WAR 395 at 452 per Ipp J.

[35] see ASIC v Adler (2002) 41 ACSR 72.

[36] [2011] FCA 717 [573].

[37] Ibid at [164].

> [Presumably, more literate than many charity governors].
>
> [567] Whilst there are many matters a director must focus upon, the financial statements must be regarded as one of the most important. As I have said repeatedly, **a director must at least understand the terminology used in the financial statements**, and in this proceeding this related to the classification of liabilities and disclosure of events occurring after the balance date.
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> …
>
> [573] I do consider that all that was required of the directors in this proceeding was the financial literacy to understand basic accounting conventions and proper diligence in reading the financial statements. The directors had the required accumulated knowledge of the affairs of Centro, based upon the documents placed before them and discussion at board meetings. Each director then needed to formulate his own opinion, and apply that opinion to the task of approving the financial statements".

3.6.2 Does this mean that all governors of religious entities (even volunteers) must understand financial statements? Some would say yes - that would be the conservative view. However, consideration of all the circumstances may provide some relief, and this questions will perhaps be more likely to turn on:

a the size of the entity;

b the size of the risk to the entity and consequences of the alleged mistake in financial governance;

c whether the governor is on the payroll or not and if so in what capacity;

d what representations the governor has made about their financial literacy;

e whether there are other governors who do possess deep technical financial know-how, including a Finance Committee;

f all governors being able to show that they have read the financials and asked questions about them.

3.7 ***Duty of skill:***

3.7.1 A governor 'has a duty greater than that of simply representing a particular field of experience or expertise. A [governor] is not relieved of the duty to pay attention to the [entity]'s affairs which might reasonably be expected to attract enquiry, even outside the area of the [governor's] expertise'.[38]

3.7.2 Therefore, governors must take steps to adequately educate themselves to a level of skill which enables them to understand and question the affairs and finances of their entity.

3.8 ***PROTECTION - Business judgment rule:***

[38] *ASIC v Healy* [2011] FCA 717 [18].

3.8.1 While the usual statutory business judgment rule in s 180(2) of the CA is switched off and is replaced by protections in the ACNC Regulations, there is also a common law version of the business judgment rule.

3.8.2 The CA includes a note at section 180(2) which states that the business judgment rule operates in relation to the duty under section 180 "and their equivalent duties at common law or in equity (including the duty of care that arises under the common law principles governing liability for negligence)".[39]

3.8.3 To be eligible for protection under the business judgment rule, the governor must:

a Make their judgment in good faith for a proper purpose;

b Not have a material personal interest in the subject matter of the judgment;

c Inform themselves about the subject matter of the judgment to the extent they reasonably believe to be appropriate; and

d Rationally believe that the judgment is in the best interests of the entity.[40]

PRACTICAL TIPS to comply with duty of care, skill and diligence

3.9 Governance not operations.

3.10 Understand the limits of executive authority (limits of delegation to management) – consider setting this out in a Limitations Policy or Delegations Policy.

3.11 Ask questions and follow on questions - necessary to make informed decisions.

3.12 Be prepared when attending meetings.

3.13 Use "Business Arising" – matters not fully closed off from the last minutes – questions asked or action directed. Close the loop. Has the question be answered or the action taken?

3.14 Diverse skill mix around the governor group.

3.15 An active and skilled Finance Committee.

3.16 Record all questions asked about financial reports in Board Minutes and who asked them – evidence that governors had formed opinions about the financials.

3.17 Training in financial literacy or reading and understanding financial reports.

3.18 Specific tips regarding the duty not to allow the charity to operate while it is insolvent (ie. ability to pay debts as and when they fall due):

[39] *Corporations Act 2001* (Cth) s180(2), see note.

[40] See, for example, *Australian Securities and Investments Commission v Rich* (2009) 75 ACSR 1.

3.18.1 Importantly, governors must be informed about the financial position of the charity.

a Reporting against cash flow forecast (not just history);

b Solvency checklist if finances get tight. Confirmation that the following have been paid in a timely manner:

i Payroll

ii PAYG

iii Super

iv GST

c Letter of comfort if finances get tight;

d Tighter delegations regarding material contracts if things get tight. Board approval required for more contracts than usual. Is there a reasonable basis for the governors to form the view that the charity will be able to perform the obligations under the contract about to be entered into?

4 DUTY OF GOOD FAITH/PROPER PURPOSE

Statutory sources:

4.1 The Corporations Act provides that a director of a corporation must "exercise their powers and discharge their duties: in good faith in the best interests of the corporations; and for a proper purpose".[41] (Civil penalty provision - s1317E).

4.2 The analogous requirement under Governance Standard 5 states that a registered charity must take reasonable steps to ensure that its governors "act in good faith in the registered entity's best interests, and to further the purposes of the registered entity".[42]

Common law duty – duty to act in good faith and in the interests of the entity

4.3 Governors owe a duty of loyalty to their entity. They cannot exercise their power for private advantage or for private purpose,[43] but rather must exercise their discretion bona fide in what they consider to be the interests of the company as a whole.[44] Determining whether a director has acted in good faith is a subjective assessment:

> "The directors are vested with the right and duty of deciding where the company's interests lie and how they are to be served, and their judgment, if exercised in good faith and not for irrelevant purposes, is not open to review by the Courts. The test, therefore, to determine whether a director has acted bona fide is subjective".

4.4 It has been held that the duty of good faith has the following aspects under common law:[45]

4.4.1 The directors must exercise their powers in the interests of the company and they must not misuse or abuse their powers;

4.4.2 They must avoid conflict between their personal interests and those of the company;

4.4.3 They should not take advantage of their position to make secret profits;[46] and

4.4.4 They should not misappropriate the company's assets for themselves.

Common law duty – duty to use powers for a proper purpose

4.5 Governors must use their powers for a proper purpose and not act oppressively.[47]

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[41] Section 181(1), *Corporations Act 2001* (Cth).

[42] Section 45:25(2)(b), *Australian Charities and Not-for-profits Commission Regulation 2013* (Cth)

[43] Ibid at 690.

[44] Haslbury's Laws of Australia, 120-7385.

[45] *Australian Metropolitan Life Assurance Co Ltd v Ure (1923) 33 CLR 199.*

[46] We note that we have not considered potential criminal sanctions under secret commissions legislation.

4.6 ***Fiduciary duty – collar on private advantage:*** Given the fiduciary relationship between a director and a company, directors cannot exercise their powers to obtain a private advantage - to do so would be an improper purpose (noting however that in promoting the interests of the company, a director may also indirectly promote his or her own interest, assuming it is not inconsistent with the best interests of the company).[48]

CASE NOTE - Glasgow East Regeneration Society

4.7 One recent case that illustrates a breach of the duty of good faith is that of Re Glasgow East Regeneration Society (Office of the Scottish Charity Regulator, 15 January 2013).[49]

4.8 The Office of the Scottish Charity Regulator commenced investigations into the affairs of the Glasgow East Regeneration Agency Ltd ("GERA"), after reports and criticism in the media that a very high severance package for the Chief Executive had been agreed to by the charity's "trustees". The severance package had been negotiated in circumstances where GERA was in the process of merging with other local regeneration agencies set up by the Glasgow City Council to fulfill a common purpose, and GERA itself was in the process of being wound-up at the time these reports surfaced.

4.9 OSCR found that the charity's trustees had agreed to a severance package for the Chief Executive in the sum of 232,708 GBP (at the time of writing, approximately $417,000 AUD).

4.10 Section 66 of the relevant legislation (that is, the Charities and Trustee Investment (Scotland) Act 2005) sets out the duty of charitable governors to act with care and diligence in the interests of the charity, and to ensure that all of a charity's assets are used in furtherance of its objects. The OSCR's investigation held that the trustees had breached this duty when agreeing to the severance package for the Chief Executive, given the significant amount of the payment and the fact that it diverted funds from the proper purpose of the charity.

4.11 Ultimately, in this case no penalties were imposed on the trustees because the payment had already been made, and GERA was in the final stages of being wound up. The OSCR report noted as follows, however, indicating that a different outcome may have occurred if the charity was continuing to operate:

> *"We consider that the actions of the charity trustees in this instance constituted misconduct in the administration of the charity. However, the payment has already been made and the charity is in the final stages of being dissolved. We find this position wholly unsatisfactory but unfortunately have no powers to recoup the funds for use in the charitable sector".*

4.12 If this case had occurred in Queensland and the assets were hold on trust then, in addition to invention by the Attorney General, "any interested person" (which could include a member or

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[47] *Australian Metropolitan Life Assurance Co Ltd v Ure (1923) 33 CLR 199.*.
[48] Halsbury's Laws of Australia, 120-7395.

[49] This case considered the statutory duties applicable to charity governors in Scotland, but is instructive on the operation of the duty of good faith generally in the context of charitable organizations.

perhaps even a generous donor) could make an application to the Supreme Court alleging a breach of trust by the trustee.

CASE NOTE – Ian Wardle & Lifeline Project Limited

4.13 In May 2019, the UK's Insolvency Service published details of the disqualification of a charity director, Ian John Wardle.[50]

4.14 The Insolvency Service found that Mr Wardle, in his capacity of a director of Lifeline Project Limited ("Lifeline") (a registered charity), breached his duty towards Lifeline by failing to act in the charity's best interests and manage the charity's resources responsibly.

4.15 In arriving at this decision, The Insolvency Service considered three profit by results contracts that Lifeline entered into between 1 August 2015 and 5 January 2016, which it considered were entered into with inadequate corporate diligence undertaken and set unachievable targets.

4.16 According to internally produced management accounts, these contracts resulted in deficits for Lifeline in excess of $1.4 million GBP.

4.17 As a result of The Insolvency Service's determination, Mr Wardle was disqualified as a company director for a period of 7 years.

4.18 In Australia, similar remedies would be available to the ACNC (suspension or removal under Division 100 of the ACNC Act, except for Basic Religious Charities), but such regulatory action has not yet been taken.

Proper purpose - do incorporated bodies hold property on charitable trust?

4.19 An extension of the general duty of governors to use their powers for a proper purpose is the duty of trustees of a charitable trust to acquaint themselves with the terms of the charitable trust and execute the trust accounting to its terms.[51]

4.20 While this duty only expressly applies to trustees of a charitable trust (and governors of a board of a corporate trustee holding property on charitable trust terms), there remains debate as to whether the duty applies more broadly in the context of charitable entities, given the requirement for all income and assets to be applied solely for the organisation's charitable purposes (see comments above at paragraphs 1.6 to 1.11). The analogy between a charitable company or association bound to apply its assets towards its charitable purposes and the concept of a charitable trust is clear - see below comments from an English commentator:

[50] Mr Wardle was disqualified for breach of a statutory duty under the relevant UK legislation – however, the matter is instructive on the operation of the duty of good faith generally in the context of charitable organizations.

[51] *Commissioner of Taxation v Bargwanna* (2012) 244 CLR 655; [2012] HCA 11 at [10].

> "The rationale of a charitable company is far more akin to that of a charitable trust than to that of a commercial company… Charities have adopted the company structure because of the advantages of limited liability. This does not mean that they have adopted the whole ethos of companies in general. Charitable companies have a different history and serve a different purpose from commercial companies. They exist to carry out a particular charitable purpose and not to make a profit for their members".[52]

4.21 Accordingly, the question has been raised (and the debate continues) as to whether property held by a charitable incorporation association or company imports a charitable trust and corresponding trustee obligations.

4.22 Judicial commentary on this issue has eschewed any absolute statement in this area. As a general position, it has been reasoned that there is no need for the imposition of a trust in the context of a company that exists for charitable objects, because in any event it is bound by its objects to apply the funds for charitable purposes.[53] It is therefore perhaps unlikely that a charity structured as a corporation or incorporated association will be found to hold all of its assets on trust.

4.23 However, it is possible for certain gifts to a charitable organisation to be impressed with charitable trust obligations, if this was a term of the gift.

4.24 Additionally, the language of the constitution of the trustee entity may import the language of "trust".

CASE NOTE - Eurella House case

4.25 The 2010 case of Eurella Community Services Inc v Attorney-General[54] illustrates the concepts discussed above regarding the impression of charitable trust obligations on a charitable entity's assets despite no express trust being created.

4.26 Eurella Community Services Inc operated Eurella House - a centre to assist people with disabilities. The Attorney-General and Eurella Community Services Inc disagreed over a number of years as to the status of the property - ie. whether the Plaintiff held Eurella House absolutely, or if the property was held on charitable trust. This issue was put to the Court for determination in the 2010 case.

4.27 The property was purchased by the association in the following circumstances:

4.27.1 Two committee members executed the contract of sale "for and on behalf of" the association;

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[52] J Warburton, 'Companies and the Ultra Vires Rule' [1988] *Conv* 275 at 282-3.

[53] Dal Pont at [17.68]

[54] *Eurella Community Services Inc v Attorney-General* (NSW) [2010] NSWSC 566

4.27.2 The local Rotary Club was engaged to assist with a fundraising appeal, where Rotary members agreed to give their assistance to "help fund the purchase of a permanent premises" for the association's activities.

4.27.3 The objects of the appeal were described in many different local print media at the time – these various descriptions often included the description that the appeal was to purchase the building and provide "suitable education facilities for those subnormal children not at present accepted in departmental schools".

4.28 The Court determined that the 1953 appeal funds were not raised as an absolute gift to the Branch, but rather that the funds raised were a gift to the Branch impressed with a trust for its application to particular charitable purposes. The following considerations were of relevance to the Court's determination in this regard:

4.28.1 Despite being presently structured as an incorporated association, the Plaintiff had at the time that the property was purchased been an unincorporated association.

4.28.2 The evidence before the Court from the time that the funds were raised indicated that donors were focused the fundraising for the charitable purpose of purchasing and establishing a school at the Eureka House site - the focus was not on the Plaintiff's acquisition of the site, but more on the objective of the donations being sought.

4.28.3 The fundraising appeal had "a public character that went well beyond the single institution" represented by the plaintiff. The involvement of others (including a combined Mayoral Appeal and the local Rotary Club) indicated that the fundraising appeal was for the charitable purpose itself, rather than the institution based on its need to carry out a particular project or purpose.

4.28.4 A trust deed was put in place in 1958 (that is, 5 years after the property was acquired) which evidenced the intentions of the 1953 fundraising appeal, and in particular, recited the intention that the property was to be managed and administered by the Branch but was silent on whether the Branch was to be the owner or beneficiary of the property.

4.29 In arriving at this conclusion, the Court cited the decision in *Attorney General for the State of Queensland v The Corporation of the Lesser Chapter of the Cathedral Church of Brisbane* (1976) 136 CLR 353, quoting as follows (**emphasis added**):

4.29.1 "It is necessary to make clear this distinction between a gift to an institution impressed with a trust for the application thereof to particular purposes and an absolute gift to such an institution as a result for instance of an appeal by the institution for funds based on its need for moneys in order to carry out a particular project or purpose. The distinction is one which can be difficult in its particular application. Where the expressed purpose is not a charitable purpose the gift will fail if the purpose is held to create a trust unless the trust is found to be a private trust enforceable by the donor until the purpose had been achieved, but meanwhile revocable - the so-called trust of imperfect obligation where there is a resulting trust to the donor if the moneys are not expended. Such a gift may, however, be construed as an absolute gift motivated by the expressed intention of the institution. **However, if the purpose of the gift is a charitable purpose, the charitable purpose will more likely than not impress the subject matter of the gift with a charitable trust"**.

4.30 Once this was established, it then followed the Court was required to determine the terms of the existing trust and the ongoing obligations of the association's governors in their role as trustees for the Eurella house property.

4.31 This case illustrates that the concepts discussed above regarding the impression of charitable trust obligations is more than an academic exercise - the Court can intervene in such cases to determine that trust obligations do in fact exist, which adds significant dimension to the obligations of a charity's governors. Charities should be mindful of the potential implications of accepting gifts or fundraising for a particular purpose, and the obligations that may follow.

PRACTICAL TIPS - Duty to act honestly and fairly in the best interests of the charity and for its charitable purposes

4.32 A governors' first priority must be to the charity. Decisions must be made from the viewpoint of the charity's best interests, and what would further its charitable purpose.

4.33 This duty must take priority over any personal interests of the governor, or the interests of any other organisation.[55]

4.34 Ongoing disclosure in a Conflicts Register of:

4.34.1 Business interests;

4.34.2 Other governance roles;

4.34.3 Employment roles.

4.35 Annual self-evaluation / conversation with the Chair (Deputy Chair) – anything that might be impeding your duty to act in the best interests of the charity alone?

4.36 If a charity is making an appeal for support, take care in appeals for support for a particular purpose, as this (conservatively) may impress these gifts with specific charitable trust obligations which the governors will need to ensure are discharged in the application of those monies.

4.37 If fundraising is undertaken or gifts are left on specific trust terms, separately account for these gifts and their application (by line items in the balance sheet and P&L statements).

[55] Australian Government, *Running a Charity* (23 May 2017) Australian Charities and Not-for-profits Commission <https://www.acnc.gov.au/tools/webinars/running-charity>.

5 DUTY TO AVOID CONFLICTS OF INTEREST

Statutory source

5.1 The Corporations Act provides that a director of a company who has a material personal interest in a matter that relates to the affairs of the company must give the other directors notice of the interest (subject to a number of exceptions).

5.2 The analogous requirement under Governance Standard 5 states that a registered charity must take reasonable steps to ensure that its governors disclose perceived or actual material conflicts of interest.[56]

5.3 For ACNC entities, External Conduct Standard 3 (counter fraud and anti corruption) introduces a further requirement to "document" any perceived or actual material conflicts of interest for their employees, volunteers, third parties and responsibile entities outside Australia. We are seeing "Conflict Registers" used as a result.

A note on Related Party Transactions

5.4 Regulation 45.25(2)(e) of the ACNC Regulations requires charities to ensure that its responsible persons "disclose perceived or actual material conflicts of interest of the responsible [person]". A note to that sub-regulation states that:

> *A perceived or actual material conflict of interest that must be disclosed is a **related party transaction**.*

5.5 Many governors of charities are governors of more than one charity. Often, they are governors of two charities which are related or often have dealings with each other – whether by contracting with one another, or one entity being the subsidiary of another. A common example of this is a Church which "operates" a school as part of its charitable purpose. Often, the Church entity will be the sole member of the school entity (making the school the subsidiary of the Church), and the governors of the Church entity will be the same - or predominantly the same - as the governors of the school entity (the "**Church/School Example**"). Alternatively the 'entities' may be separate business units of a single legal entity or unincorporated association.

5.6 This section of the Paper will address the nature of governors' duties in such a parent-subsidiary relationship where a governor is a governor of **both** entities.

5.7 In addition to Governance Standards, the Related Party provisions of the CA (sections 207 and following) also need to be considered (as they have not been turned off by the ACNC legislation). A parent/subsidiary will be related as the parent *controls* (as that term is defined) the subsidiary[57]. These provisions require member approval (including notification to ASIC) for related party transactions unless an exemption can be relied upon. The exemption that

[56] Section 45:25(2)(e), *Australian Charities and Not-for-profits Commission Regulation 2013* (Cth)

[57] *Corporations Act 2001* (Cth), s 228.

would be relied upon in the context of common boards would usually be section 210 which provides as follows:

> ***Arm's length terms***
>
> *Member approval [and notification to ASIC] is **not** needed to give a financial benefit on terms that:*
>
> *(a) would be reasonable in the circumstances if the public company or entity and the related party were dealing at arm's length; or*
>
> *(b) are less favourable to the related party than the terms referred to in paragraph (a).*

5.8 Government funders (including re-current funders in a School context) may have governance requirements especially impacting related party transactions - that if not complied with, may see a loss of government funding. See for example, *Malek Fahd Islamic School Limited and Minister for Education and Training* [2016] AATA 1087 (23 December 2016).

5.9 The definition of "public company" (s9 CA) for the purposes of the related party provisions includes "*entities"* (broadly defined)[58] it controls and:

5.9.1 Includes companies limited by guarantee;

5.9.2 If a company limited by guarantee has been licensed by ASIC to omit limited by its name under s150 of the CA, the related party provisions of the CA do not apply to it but similar duties arise at common law;

5.9.3 State and territory incorporated associations are included.[59]

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[58] ***"entity "*** : for the purposes of Chapters 2E and 8A an ***entity*** is any of the following:

(a) a body corporate;

(b) a partnership;

(c) an unincorporated body;

(d) an individual;

(e) for a trust that has only 1 trustee--the trustee;

(f) for a trust that has more than 1 trustee--the trustees together.

Otherwise, ***entity*** has the meaning given by section 64A. (s9 CA)

[59] Due to the definition of "public company" in s9 of the CA which provides as follows: ***"public company "*** means a company other than a proprietary company and:

(a) in section 195 and Chapter 2E, includes a body corporate (other than a prescribed body corporate) that:

(i) is incorporated in a State or an internal Territory, but not under this Act; and

(ii) is included in the official list of a prescribed financial market; and

How does a Board determine arms length commercial terms?

5.10 The ASIC Regulatory Guide 76[60] provides some very useful guidance on the meaning of arm's length in the context of the CA (but is also very instructive about what the term may mean at common law), including:

> *RG 76.62: The Corporations Act does not define 'arm's length'. Case law on the meaning of 'arm's length' suggests that this phrase refers to a relationship between parties where neither bears the other any special duty or obligation, they are unrelated, uninfluenced and each acts in its own interests.*
>
> *RG 76.64: Specifically,* ASIC v Australian Investors Forum *at [456] indicates that, in determining the objective standards that would characterise arm's length terms, courts should consider* ***the transaction terms that would result if:***
>
> a. the parties to the transaction were unrelated in any way (e.g. financially, or through ties of family, affection or dependence);
>
> b. the parties were free from any undue influence, control or pressure;
>
> c. through its relevant decision-makers, each party was sufficiently knowledgeable about the circumstances of the transaction, sufficiently experienced in business and sufficiently well advised to be able to form a sound judgement as to what was in its interests; and
>
> d. each party was concerned only to achieve the best available commercial result for itself in all the circumstances.
>
> *RG 76.70: At a minimum, public companies ... should take into account all of the following factors when deciding whether ... the arm's length exception in s 210 applies:*
>
> a. how the terms of the overall transaction compare with those of any comparable transactions between parties dealing on an arm's length basis in similar circumstances (see RG 76.75–RG 76.79);
>
> b. the nature and content of the bargaining process, including whether the entity followed robust protocols to ensure that conflicts of interest were appropriately managed in negotiating and structuring the transaction (see RG 76.80–RG 76.85);
>
> c. the impact of the transaction on the company ... (e.g. the impact of dealing on those terms on the financial position and performance of the company) and non-associated members (see RG 76.86–RG 76.88);
>
> d. any other options that may be available to the entity (see RG 76.89); and

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(b) in Chapter 2E [Related Party provisions] does not include a company that is not required to have "Limited" in its name because of section 150 or 151.

[60] https://download.asic.gov.au/media/1239851/rg76-published-11-may-2011.pdf.

e. expert advice received by the entity on the transaction (if any) (see RG 76.90–RG 76.91).

RG 76.90: Directors should ensure they have, or have access to, enough knowledge or expertise to assess all aspects of proposed related party transactions—where necessary, they should obtain appropriate professional and expert advice from any appropriately qualified person.

RG 76.91: The directors will need to be satisfied that it is appropriate to rely on the expert advice, including that the opinion given by the expert is directly relevant to the decision at hand. However, directors relying on information, professional advice or expert advice provided by others must make their own independent assessment of the information or advice: see s189. Advice does not replace careful judgement by the directors.

Duty to avoid conflicts of interest at common law

5.11 Governors must be independent and must be free to make decisions for the company. That independence is compromised when there is a conflict between the director's personal interests and that of the company.

5.12 At common law, Directors have a fiduciary obligation not to enter into an engagement in which they have a personal interest. Given the diversity of circumstances in which this duty may be applied, it can only be stated in general terms.[61] However, the classic formulation of this rule is derived from the case of *Bray v Ford*:

> "It is an inflexible rule of a Court of Equity that a person in a fiduciary position ... is not, unless otherwise expressly provided, entitled to make a profit; he is not allowed to put himself in a position where his interest and duty conflict".[62]

5.13 Significantly, this obligation extends beyond actual, present conflicts to situations which ***may possibly conflict*** with the personal interests of a Director:

> "It is a rule of universal application, that no one, having such duties to discharge, shall be allowed to enter into engagements in which he has, **or can have**, a personal interest conflicting, or which possibly may conflict, with the interests of those whom he is bound to protect".[63]

5.14 A breach of this duty is committed immediately when a Director enters into a transaction which is inconsistent with the fiduciary relationship:

> "It is not necessary to show that the fiduciary has put personal interest ahead of duty. The breach occurs when he or she places himself or herself in a position in which there is the possibility of a conflict between the two".[64]

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[61] *Boardman v Phipps* [1967] 2 AC 46 at 12

[62] [1896] AC 44

[63] *Aberdeen Railway Co v Blaikie Bros* (1854) 1 Macq 461

[64] *Aberdeen Railway Co v Blaikie Bros* (1854) 1 Macq 461

5.15 Put another way – the breach of duty occurs immediately when the fiduciary enters into a conflicted transaction, and proof of subsequent causative consequences of that condition is not a pre-condition to a cause of action against that director in respect of the breach.[65]

PROTECTION: Disclosure, management of conflict & informed consent

5.16 Accordingly, a Director must refrain from pursuing, obtaining or retaining for himself or herself any collateral advantage without appropriate informed consent. Obtaining consent requires the Director to make a full and accurate disclosure; any inaccuracies conveyed, whether done so recklessly or deliberately, will result in a breach of duty.[66]

5.17 Where the Director has failed to make a full disclosure, it is no defence to show that no loss was caused to the company or that any profit made could not have been obtained by the company:

> "An undisclosed profit which a director so derives from the execution of his fiduciary duties belongs in equity to the company. It is no answer to the application of the rule that the profit is of a kind which the company could not itself have obtained, or that no loss is caused to the company by the gain of the director."[67]

PRACTICAL TIPS - Duty to disclose [and appropriately manage] material conflicts of interest (and record in writing – EC Standard)

5.18 What does your Constitution say – does it need to be amended?

5.19 Policy & Procedure (follow the procedure as this is about appropriate management of the conflict)

5.20 Conflicts Register / Minute conflicts disclosure

5.21 Once a conflict has been disclosed, it needs to be adequately managed. Usually, the conflicted governor should not be present at deliberations or decision-making about the conflict issue. For incorporated associations in some States and Territories there is an additional duty to disclose the conflicts at the next general meeting of the charity.[68]

5.22 A fiduciary can discharge their duty by full and frank disclosure and a benefit to the fiduciary may be provided only on arms length commercial terms

5.23 Where related party transactions are proposed the following process should be considered:

5.23.1 record the conflict in the Conflicts Register;

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[65] *Nocton v Lord Ashburton* [1914] AC 932

[66] *Biala Pty Ltd v Mallina Holdings Ltd (No 2)* (1993) 13 WAR 11

[67] *Furs Ltd v Tomkies* (1936) 54 CLR 583

[68] https://www.nfplaw.org.au/sites/default/files/media/Duties_Guide_CTH_2.pdf at [29].

5.23.2 Question - is the advancement of the related party entity part of the charitable purpose of your entity? (Alignment of Charitable Purpose) If not, must be on arms length commercial terms;

5.23.3 If yes, is your entity in receipt of government funding that may place limitations on the application of assets to the related party entity? (For example, the not-for-profit requirement in non-state school funding legislation) If yes, must be on arms length commercial terms;

5.23.4 Consider evidence of arms length commercial terms (consider ASIC regulatory guidance, and the need for written expert advice about arms length commercial terms with comparative market data as to how they have arrived at their view).

6 DUTY TO NOT IMPROPERLY USE POSITION/INFORMATION

Statutory source

6.1 Section 182 of the Corporations Act deals with improper use of position, and provides as follows:

> 6.2 A director, secretary, other officer or employee of a corporation must not improperly use their position to:
>
> (a) Gain an advantage for themselves or someone else; or
>
> (b) Cause detriment to the corporation.[69]

6.3 Section 183 deals separately with improper use of improper use of information, and provides as follows:

> A person who obtains information because they are, or have been, a director or other officer or employee of a corporation must not improperly use the information to:
>
> (e) Gain an advantage for themselves or someone else; or
>
> (f) Cause detriment to the corporation.[70]

6.4 The analogous requirement under Governance Standard 5 states that a registered charity must take reasonable steps to ensure that its governors do not misuse their position, or misuse information obtained in the performance of their duties to the charity.[71]

Common Law duty

Duty – not to improperly use position

6.5 At Common law, directors similarly are prohibited from exercising their powers to obtain a private advantage, or to obtain any purpose that is foreign to their powers as a governor.[72] Directors of a company are fiduciary agents, and the powers conferred upon them must be executed bona fide for the purpose designed.[73]

> The [fiduciary powers entrusted to a director] must be used bona fide for the purpose for which it was conferred, that is to say, to raise sufficient capital for the benefit of the

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[69] Section 182, *Corporations Act 2001* (Cth).

[70] Section 183, *Corporations Act 2001* (Cth).

[71] Section 45:25(2)(c)-(d), *Australian Charities and Not-for-profits Commission Regulation 2013* (Cth)

[72] *Mills v Mills* (1938) 60 CLR 150

[73] Ibid

company as a whole. It must not be used under the cloak of such a purpose for the real purpose of benefiting some shareholders or their friends at the expense of other shareholders.[74]

6.6 The principles the Courts utilise to determine whether the duty not to act for an improper purpose has been breached are well settled:

6.6.1 Fiduciary powers and duties of directors may be exercised only for the purposes for which they were conferred and not for any collateral, or improper purpose;

6.6.2 It must be shown that the substantial purpose of the directors was improper or collateral to their duties as directors of the company. The issue is not whether a management decision was good or bad; it is whether the directors acted in breach of their fiduciary duties.

6.6.3 Honest or altruistic behaviour by directors will not prevent a finding of improper conduct on their part if that conduct was carried out for an improper or collateral purpose. Whether acts were performed for a proper purpose is to be objectively determined, although statements by directors about their subjective intentions or beliefs will be relevant to that inquiry.

6.6.4 The court must determine whether but for the improper or collateral purpose the directors would have performed the act impugned.[75]

6.7 The process through which these principles are applied is two-fold:

6.7.1 Considering the power whose exercise is in question. This must be ascertained through a contemplation of the nature of this power, and in light of the modern conditions, the limits which may be exercised; and

6.7.2 Examining the substantial purpose for which the power was exercised.[76]

6.8 Significantly, credit is given to the bona fide opinion of the directors. That is, "before the exercise of a discretionary power by directors will be interfered with by the court it must be proved by the complaining party that they have acted from an improper motive or arbitrarily capriciously"[77].

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[74] *Ngurli v McCann* 90 CLR 425

[75] *Permanent Building Society (in Liq) v Wheeler and Others* (1994) 14 ACSR 109

[76] *Mills v Mills* (1938) 60 CLR 150; Howard Smith v Ampol Petrroleum Ltd (1974) 3 ALR 448

[77] *Mills v Mills* (1938) 60 CLR 150

Duty – not to improperly use information

6.9 Directors are subject to the general equitable obligation not to take advantage of information or property acquired by virtue of their position. Directors breach this duty where they personally take up an opportunity that was otherwise available to the entity.[78]

6.10 Directors cannot retain any benefit from such an opportunity and may be required to provide an account of profits to the entity to which they owed the duty.[79]

6.11 Challenges arise where the governor is appointed to the board of a related or competing entity. In such circumstances, the governor must be mindful of confidential information being wrongly used, including conscious or unconscious use or disclosure.[80]

6.12 Where a governor stands to gain benefits (either personally or for a related entity which they act as a governor for) from the decision of an entity that person owes a fiduciary duty, that person is bound to **disclose everything, with strict and scrupulous accuracy**, which may affect the decisions.[81]

PRACTICAL TIPS - Duty not to misuse their position or information they gain as a Responsible Person

6.13 This can cause tension where the Board/Committee member is the appointee of another organisation – these obligations of confidence still apply notwithstanding the appointor's interest in the subject matter. A governor "*can't ignore [their] primary obligation to the organisation that [they] have been appointed to, even if [they] think that their 'appointing organisation' would benefit from that information. [They] should report back to [their] 'appointing organisation' only with authorisation of the committee.*"[82]

6.14 Consider express standing authorisation (ideally in the Constitution) to share information with a Board of sole member charity.

[78] *Cooks v Deeks* [1916] 1 AC 554

[79] Ibid.

[80] *Riteway Express Pty Ltd v Clayton* (1987) 10 NSWLR 238

[81] *Biala Pty Ltd v Mallina Holdings Ltd* (No 2) (1993) 13 WAR 11

[82] Australian Government, *Running a Charity* (23 May 2017) Australian Charities and Not-for-profits Commission <https://www.acnc.gov.au/tools/webinars/running-charity>..

7 PROTECTIONS (IN ADDITION TO THOSE ALREADY MENTIONED)

7.1 For charities registered with the ACNC, there are protections available for governors who take certain "reasonable steps" to ensure compliance with the duties set out in Governance Standard 5.

7.2 **Protection 1 – Good faith in reliance on advice -** Section 45:105 provides as follows:

> ***45.105*** ***Protection 1 [Good faith in reliance on advice]***
>
> *(1) A responsible entity meets this protection if the responsible entity, in the exercise of the responsible entity's duties, relies on information, including professional or expert advice, in good faith, and after the responsible entity has made an independent assessment of the information, if that information has been given by:*
>
> *(a) an employee of the registered entity that the responsible entity believes on reasonable grounds to be reliable and competent in relation to the matters concerned; or*
>
> *(b) a professional adviser or expert in relation to matters that the responsible entity believes on reasonable grounds to be within the individual's professional or expert competence; or*
>
> *(c) another responsible entity in relation to matters within their authority or area of responsibility; or*
>
> *(d) an authorised committee of responsible entities that does not include the responsible entity.*

7.3 An analogous protection exists under section 189 of the CA, which is stated to apply to a director exercising their duty under both the CA "or an equivalent general law duty".[83]

7.4 **Protection 2 – Business judgment – best interests of the charity -** This protection specifically relates to the duty mentioned in paragraph 45:25(2)(a).

[83] *Corporations Act 2001* (Cth), s189 (c).

45.110 ***Protection 2 [Business judgment – best interests of the charity]***

(1) A responsible entity meets this protection if the responsible entity makes a decision in relation to the registered entity, and the responsible entity meets all of the following:

(a) the responsible entity makes the decision in good faith for a proper purpose;

(b) the responsible entity does not have a material personal interest in the subject matter of the decision;

(c) the responsible entity informs itself about the subject matter of the decision, to the extent the entity reasonably believes to be appropriate;

(d) the responsible entity rationally believes that the decision is in the best interests of the registered entity.

Note 1: Protection 2 is also referred to as the "business judgement rule".

Note 2: Protection 2 relates to the duty mentioned in paragraph 45.25(2)(a).

1.1.2 *(2) In this section: **decision** means any decision to take, or not take, action in relation to a matter relevant to the operations of the registered entity.*

7.5 We note that this protection is analogous to the business judgment rule contained in section 180(2) of the Corporations Act,[84] which applies in respect both of the duty of care and diligence under the Corporations Act and also the equivalent duties at common law and in equity.[85]

[84](2) A ***director*** or other ***officer*** of a corporation who ***makes*** a business judgment is taken to meet the requirements of ***subsection*** (1), and their equivalent duties at common law and in equity, in respect of the judgment if they:

(a) ***make*** the judgment in good faith for a proper purpose; and

(b) do not have a material ***personal interest*** in the subject matter of the judgment; and

(c) inform themselves about the subject matter of the judgment to the extent they reasonably believe to be appropriate; and

(d) rationally believe that the judgment is in the best ***interests*** of the corporation.

[85] Section 180(2), *Corporations Act 2001* (Cth).

7.6 **Protection 3 – Reasonable basis for solvency**

> ***45.115 Protection 3 [Reasonable basis for solvency]***
>
> *A responsible entity meets this protection if:*
>
> *(a) at the time when the debt was incurred, the responsible entity had reasonable grounds to expect, and did expect, that the registered entity was solvent at that time and would remain solvent even if it incurred that debt and any other debts that it incurred at that time; or*
>
> *(b) the responsible entity took all reasonable steps to prevent the registered entity from incurring the debt.*

7.7 We note that this protection is analogous to the defences to a director's duty to prevent insolvent trading as set out in section 588H of the Corporations Act. That section provides that a director will not be held to have contravened the duty to prevent insolvent trading in the following circumstances:

7.7.1 At the time when the debt was incurred, the director had reasonable grounds to expect (and did in fact expect) that the company was solvent and would remain solvent even if it incurred that debt;[86]

7.7.2 At the time when the debt was incurred, the director did not take part in the management of the company because of illness or for "some other good reason",[87]

7.7.3 The director otherwise took all reasonable steps to prevent the company from incurring the debt.[88]

7.8 **Protection 4 – Reasonable Absence -** Section 45:120 provides as follows:

> ***45.120 Protection 4 [Reasonable absence]***
>
> *This section is satisfied if, because of illness or for some other good reason, a responsible entity could not take part in the management of the registered entity at the relevant time.*

7.9 An equivalent protection exists at section 588H of the CA in respect of directors who were absent from the management of the company at the time a debt was incurred, which is solely a defence to the CA s588G duty to prevent insolvent trading.

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[86] Section 588H(2), *Corporations Act 2001* (Cth)

[87] Section 588H(4), *Corporations Act 2001* (Cth).

[88] Section 588H(5), *Corporations Act 2001* (Cth).

8 ENFORCEMENT OF GOVERNORS DUTIES

ACNC Governance Standards

8.1 Enforcement powers under Part 4-2 of the ACNC Act may arise if the charity is a 'federally regulated entity' – that is (generally), a company or incorporated association.[89] An unincorporated association, even if not considered a basic religious charity and therefore subject to the Governance Standards, will not be a federally regulated entity.

8.2 Further, where a registered charity is found to have failed to take reasonable steps to ensure that its governors are subject to, and comply with, the duties under Governance Standard 5, the ACNC may take action against those governors via suspension, removal or disqualification.[90] To date the ACNC reports that it has not used this power.

8.3 However, the ACNC is recorded as having revoked charity registration retrospectively for failure to properly record keep (and we suggest, comply with the ACNC Governance Standards).

8.4 Revocation of Charity status retrospectively for non-compliance with record keeping obligation is in Part 3-2 of the ACNC Act. See: *Fenn v ABC* [2018] VSC 60 (16 February 2018) and subsequent appeal on pleading issues. However the matters asserted in the following published pleadings in an unreported judgement on the pleadings appeal to the Court of Appeal do not seem to be contested:

> *7C.1 On 3 December 2012, Ethan was registered as a charity on the charity register of the ACNC.*
>
> *7C.2 The ACNC is a Commonwealth statutory body operating as Australia's independent national regulator of charities pursuant to the Australian Charities and Not-for-profits Commission Act 2012 ('the ACNC Act') and the Australian Charities and Not-for-profits Commission Regulation 2013 ('the ACNC Regulations').*
>
> *7C.3 The ACNC Act and the ACNC Regulations prescribe **governance standards** that entities registered with ACNC ('charities') are required to meet ('the ACNC **Governance Standards**').*
>
> *7C.4 The object of the ACNC **Governance Standards** is to provide a minimum level of confidence that charities will (amongst other things):*
>
> > *7C.4.1 effectively, efficiently and responsibly use the resources available to them;*
> >
> > *7C.4.2 meet community expectations about managing their affairs (including the use of public money, volunteer time and donations);*
> >
> > *7C.4.3 minimise the risk of mismanagement and misappropriation;*

[89] Ramsay & Webster, p.28.

[90] ACNC Act ss100-5(1)(b), 100-10(1), 100-15(1).

7C.4.4 operate transparently and for a proper purpose; and

7C.4.5 meet their obligations under the ACNC Act and the ACNC Regulations.

7C.5 As part of its regulatory role, the ACNC is:

7C.5.I responsible for the registration and revocation of charities; and

7C.5.2 required to maintain, protect and enhance public trust and confidence in the not-for-profit and charities sector by ensuring that charities are accountable and transparent.

7C.6 The most serious action the ACNC can take against a charity is to revoke its Commonwealth charitable status. The ACNC will take action and revoke charitable status if it identifies serious mismanagement or misappropriation of funds; a persistent or deliberate breach of the ACNC Act; or that vulnerable people or significant charitable assets are at risk.

7C.7 Charities that have their charitable status revoked lose access to Commonwealth charity tax concessions.

7C.8 The ACNC launched an investigation into the activities and operations of Ethan and assessed Ethan's eligibility for registration as a charity and its compliance with the ACNC ***Governance Standards****.*

7C.9 The ACNC's investigation revealed that Ethan had failed to comply with its obligations under Part 3–2 of the ACNC Act with respect to record keeping over two consecutive lodgement years.

7C.10 Following its investigation into Ethan, on 25 July 2016, the ACNC revoked Ethan's charitable status and backdated the revocation to 1 July 2013.

7C.11 In an email letter to the ABC on or about 12 December 2016 the Plaintiffs confirmed that they had received a notice from the ACNC setting out the reasons for the revocation of Ethan's charitable status but declined to provide a copy to the ABC.

8.1 It also has powers that it can take against individual governors (of federally regulated charities), being suspension and removal. This may have an impact in for-profit roles held by the governor. For example, failure to comply with the External Conduct Standards can result in consequences for governors. If the Commissioner reasonably believes that a charity (which is not a basic religious charity[91]) hasn't complied with an external standard (or is likely not to comply with an external conduct standard)[92], the Commissioner may:

8.1.1 Suspend any of the governors (following provision of a show cause notice and a 28 day period for the charity to respond)[93]; or

8.1.2 Remove any of the governors (following provision of a show cause notice and a 28 day period for the charity to respond)[94] and disqualify them from being eligible

[91] *Australian Charities and Not-for-profits Commission Act 2012* (Cth), s 100.5(3).
[92] Ibid at s 100.5(1)(c).
[93] Ibid at s 100.10.
[94] Ibid at s 100.15.

to be a governor of another charity[95]. The ACNC has not yet disqualified any responsible persons (see: https://www.acnc.gov.au/charity/about-charity-register/information-charity-register/disqualified-persons-register).

Corporations Act

8.5 While the civil penalty provisions for directors duties are switched off for companies registered as charities with the ACNC (ie. sections 180-183), a number of enforcement options under the Corporations Act remain in force for registered charities. We note that the enforcement actions set out below may be applied concurrently to action initiated by the ACNC as set out above.

8.6 Importantly, we note that that section 184 of the Corporations Act is not switched off for registered charities. This section provides that a director commits a **criminal offence** if they are reckless or intentionally dishonest and fail to exercise their powers and discharge their duties in the best interests of the corporations or for a proper purpose.[96] If also provides that a director commits an offence if they use their position dishonestly or dishonestly use information obtained by their position.[97]

8.7 We note that the duty of care (set out in section 180, which is turned off for registered charities) is not covered by the criminal offences in section 184 - however, it is possible that cases of serious misconduct which would amount to a breach of section 180 will be covered given the overlap between the duty of care and the duty of good faith and proper purposes (particularly in relation to inquiry, consideration and investigation).[98]

8.8 We also note that section 588G regarding insolvent trading (see paragraph 3.3 above) which is not turned off for registered charities provides that ASIC may initiate civil penalty or criminal proceedings in respect of a breach.[99]

Taxation Administration Act 1953 (Cth)

8.9 It has long been the case that the ATO can hold company directors personally liable for unpaid tax of an entity. This is relevant if a tax concession charity lost its endorsement retrospectively and tax assessments issued which remained unpaid.

8.10 Treasury Laws Amendment (2018 Measures No 4) Act 2019 (Cth) passed in March 2019, and provides the ATO with the power to pursue significant penalties for directors in relation to sufficiently serious contraventions of employer superannuation guarantee obligations. Directors may be held jointly and severally liable for unpaid SGC, and face either financial penalties or up to 12 months imprisonment.

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[95] Ibid at s 100.20(2).
[96] *Corporations Act 2001* (Cth), s184(1)

[97] *Corporations Act 2001* (Cth), ss184(2)-(3)

[98] Ramsay & Webster, p.31.

[99] *Corporations Act 2001* (Cth), s588G.

8.11 We note that a second piece of legislation, namely the Treasury Laws Amendment (Combating Illegal Phoenixing) Bill 2019, was recently introduced but lapsed at dissolution in parliament in April 2019. This act sought to extend the director penalty regime to hold directors personally liable for outstanding GST in certain circumstances. Watch this space for future legislation to address this issue.

8.12 Given that an unincorporated association is considered an 'entity' by the ATO for the purposes of taxation, personal liability for unpaid tax can be imposed on governors of the association (both jointly and severally). Schedule 1, Section 444-5 of the Taxation Administration Act provides as follows:

> **Section 444-5 Unincorporated associations and bodies**
>
> (1) Obligations that would be imposed under this Schedule or an indirect tax law on an unincorporated association or body of entities are imposed on each member of the committee of management of the association or body, but may be discharged by any of those members.
> (2) Any offence against this Schedule or an indirect tax law that is committed by the association or body is taken to have been committed by each member of its committee of management.
> (3) In a prosecution of an entity for an offence that the entity is taken to have committed because of subsection (2), it is a defence if the entity proves that the entity:
> a. Did not aid, abet, counsel or procure the relevant act of omission; and
> b. Was not in any way knowingly concerned in, or party to, the relevant act or omission (whether directly or indirectly and whether by any act or omission of the entity).
>
> Note – "indirect tax law" is defined in section 995-1 of the *Income Tax Assessment Act 1997* (Cth) to include the GST law, wine tax taw,, luxury car tax law, and fuel tax law.

8.13 Where an unincorporated association is endorsed as a tax concession charity and is no longer eligible for that registration (see paragraph 1.10),

426-45 Telling Commissioner of loss of entitlement to endorsement

(1) Before, or as soon as practicable after, an entity that is endorsed ceases to be entitled to be endorsed, the entity must give the Commissioner written notice of the cessation.

…

Note 2: Section 426-50 modifies the way this subsection operates in relation to partnerships and unincorporated bodies.

…

426-50 Partnerships and unincorporated bodies

…

(2) If, apart from this subsection, section 426-40 or 426-45 would impose an obligation on an unincorporated association or body, the obligation is imposed on each member of the committee of management of the association or body, but may be discharged by any of the members of the committee.

Defences for partners and members of committee of management

(3) In a prosecution of a person for an offence against section 8C of this Act because of subsection (1) or (2), it is a defence if the person proves that the person:

a. did not aid, abet, counsel or procure the act or omission because of which the offence is taken to have been committed; and

b. was not in any way, by act or omission, directly or indirectly, knowingly concerned in, or party to, the act or omission because of which the offence is taken to have been committed.

Incorporated Associations

8.14 Where duties exist for management committee members in the relevant state or territory legislation, a breach of those duties may give rise to civil or criminal proceedings depending on both the particular duty and the jurisdiction concerned.[100]

8.15 In circumstances where it can be established that the committee members also owed a fiduciary duty to the association at common law, a breach of those duties may also be enforceable at common law by the association (through civil action commenced by its management committee).[101]

[100] Ramsay & Webster, p.32.

[101] Ramsay & Webster, p.34.

Common law duties

8.16 Governors owe their fiduciary duties at common law to the company itself (rather than individual members or other directors), and the company may seek damages where it has suffered loss or damage as a result of a breach of such duties.[102]

8.17 Where a director bas breached their fiduciary duty to avoid conflicts of interest and they improperly receive a benefit as a result, a director may be required to give account of profits for that benefit.[103]The company may seek equitable damages or equitable compensation, not just concerning the profit that has been made, but also in respect of any detriment suffered by the company as a result.[104]

8.18 We query whether action may be taken by another governor at common law, for contribution where personal liability has resulted from a breach of duty by another director – such an action would be novel, but not unforeseeable. Deeper enquiry into this possibility goes beyond the scope of this paper.

Charitable trusts

8.19 Unlike the trustees of a private trust, the trustees of a charitable trust do not owe duties directly to individual beneficiaries, but rather their duties are owed to promoting the charitable objects of the trust.[105] However, given that an abstract charitable purpose is unable to bring proceedings against a trustee for breach of trust, the proper plaintiff to sue a trustee in respect of a breach of trust is generally regarded as the Attorney-General.[106]

8.20 The Courts have broad powers under the state and territory trusts legislation to make orders in relation to trustees who have breached the trust or their fiduciary duties, including the power to remove and replace a trustee where the trustee has 'breached its fiduciary duties, has acted, or failed to act, in circumstances that endanger the trust property or has displayed a lack of honesty'.[107]

8.21 In addition, the *Trusts Act 1973* (Qld) provides as follows:

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[102] *Permanent Building Society (in liq) v Wheeler* (1994) 11 WAR 187

[103] *Boardman v Phipps* [1967] 2 AC 46.

[104] *Biala Pty Ltd v Mallina Holdings Ltd* (no 2) (1993) 13 WAR 11

[105] Dal Pont, at [17.25]

[106] Dal Pont, at [17.36].

[107] Ramway & Webster, p. 32 - see also, Trustee Act 1975 (ACT) s70; Charitable Trusts Act 1993 (NS) s7-8; Trustee Act 1925 (NSW) s 70; Trustee At (NT) s 27; Trusts Act 1973 (Qld) s 80; Trustee Act 1936 (SA) s 36; Trustee Act 1898 (Tas) s 32; Trustee Ac 1958 (Vic) s 48; Trustee Act 1962 (WA) s 77.

Section 106 – Proceedings in case of charitable trust

(1) The court may upon application under this section by an order in respect of any charitable trust:

(a) give directions in respect of the administration of the trust; and

(b) require any trustee to carry out the trust, or to comply with a scheme (if any); and

(c) require any trustee to satisfy the trustee's liability for any breach of the trust.

(2) An application under this section may be made:

(a) by the Attorney-General or person authorised by the Attorney-General; and

(b) by the charity, or any trustee of the trust; and

(c) by any person interested in the due administration of the trust.

(3) Notice of the application shall be given to the Attorney-General, and to the trustee of the trust and to such other person as the court directs.

8.22 In recent years, the Court's powers under section 106 have been invoked by various trustees[108] in a small number of matters largely concerning a request for the Court to make a declaration as to the interpretation of a trust instrument.

8.23 We are not aware of any case in Queensland that considers the meaning of "any person interested in the due administration of the trust" - however, section 106(2)(b) would indicate that this category of persons is broader than the charity itself or the trustee of the trust. We question whether a donor, disgruntled by the trustee's application of their gift, may be considered a person sufficiently interested in the due administration of the trust for the purposes of this section.

8.24 Similar provisions exist in New South Wales, with the *Charitable Trusts Act 1993* (NSW) regulating the conduct of charitable trust proceedings - defined as proceedings brought "whether by any trustee of a charitable trust or by any other person… with respect to any breach or supposed breach of a charitable trust, or with respect to the administration of a charitable trust".[109]

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[108] See, for example - *In the matter of the Public Trustee of Queensland as trustee of Queensland Community Foundation* [2016] QSC 276; James Cook University v Townsville City Council & Anor [2011] QSC 209

[109] *Charitable Trusts Act 1993* (NSW), s 5.

8.25 Again, we are not aware of any cases where the terms of the Charitable Trusts Act 1993 (NSW) have been invoked by any person other than a trustee or the Attorney-General – however, the language of section 5 of that Act as set out above would indicate that a broad class of persons (ie. a trustee or "any other person")) may seek to bring proceedings with respect to a supposed breach of charitable trust.

9 LESSONS FOR CHARITY GOVERNORS FROM RECENT ROYAL COMMISSIONS

9.1 The outcomes of two recent Royal Commissions have highlighted issues regarding governance culture which are applicable (both directly and indirectly) to governors of religious institutions.

Royal Commission into Institutional Responses to Child Sexual Abuse

9.2 The findings of the Royal Commission into Institutional Responses to Child Sexual Abuse should be fresh in the minds of all religious institutions.

9.3 While the Royal Commission looked into institutional responses broadly (including many secular institutions), undoubtedly religious institutions were highlighted in their historical failures to safeguard children in their care. The Royal Commission concluded that "cultural, governance and theological factors" were all common elements in the occurrences of sexual abuse reported in religious institutions, where the structure and governance of those religious institutions may have contributed to their failure to effectively respond to allegations:

9.3.1 "In some cases, the structure and governance of religious institutions may have inhibited effective institutional responses to child sexual abuse. Independent, autonomous or decentralised governance structures often served to protect leaders of religious institutions from being scrutinised or held accountable for their actions, or lack of action, in responding to child sexual abuse. At times, the structure and governance of particular religious institutions gave rise to conflicts of interest for those involved in responding to allegations of child sexual abuse. In some instances religious leaders showed a lack of understanding of or disregard for perceived or actual conflicts of interest in circumstances where there were inadequate checks and balances to regulate their personal power."[110]

9.4 Amongst the Royal Commission's 57 recommendations to religious institutions were recommendations to several institutions in particular, but also to all religious institutions generally, to consider issues of transparency, accountability, consultation and the participation of lay men and women in governance and management structures.[111]

9.5 It is also notable that in its general comments regarding governance, the Royal Commission commented on the limited diversity within governance structures in certain denominations (in particular, gender diversity) and the effect that this may have had on creating a child-safe culture within institutions:

9.5.1 "In some religious institutions, the absence or insufficient involvement of women in leadership positions and governance structures negatively affected decision-

[110] Final Report: Volume 16, Religious institutions Book 1, p.29

[111] See, for example, recommendation 16.7

making and accountability, and may have contributed to inadequate institutional responses to child sexual abuse. Leaders of both the Catholic Church and the Anglican Church told us they believed that the involvement of women in leadership positions would contribute to making their institutions safer for children".[112]

9.6 The Royal Commission's recommendations reflected these findings, with governors of religious institutions recommended to ensure broad experience at a governance level:

9.6.1 Recommendation 16.37 Consistent with Child Safe Standard 1, leaders of religious institutions should ensure that there are mechanisms through which they receive advice from individuals with relevant professional expertise on all matters relating to child sexual abuse and child safety. This should include in relation to prevention, policies and procedures and complaint handling. These mechanisms should facilitate advice from ***people with a variety of professional backgrounds and include lay men and women***.[113]

9.7 The issue of conflicts of interest between those accused of child sexual abuse and those tasked with investigation of the allegations was raised repeatedly by the Royal Commission, with the Final Report concluding that the close relationships often present between the accused and the investigator when investigations are conducted 'in house' frequently lead to inadequate investigation of complaints. Accordingly, the following recommendation was made for all religious institutions:

9.7.1 Recommendation 16.39 Consistent with Child Safe Standard 1, each religious institution should have a policy relating to the management of actual or perceived conflicts of interest that may arise in relation to allegations of child sexual abuse. The policy should cover all individuals who have a role in responding to complaints of child sexual abuse.[114]

Banking Royal Commission

9.8 In the aftermath of the Banking Royal Commission Final Report ("Banking Report") released on 9 February 2019, it is more necessary than ever that Boards remain vigilant and educated as to their responsibilities. While the Banking Report directly refers to directors and senior executives in the financial services industry, there are lessons to be taken by all governors about how to avoid similar circumstances in their respective organisations.

9.9 In the opening of the Banking Report, the primary responsibility for the misconduct in the financial services industry was placed squarely at the feet of the boards and senior

[112] Book 1, p.29

[113] Book 1, p.79

[114] Book 1, p.79

management of the entities in question.[115] The failing that led to the misconduct included organizational culture, governance and remuneration.

9.10 The Banking Report also points to markers of good governance, including the importance of the board challenging management, and ensuring that there is adequate disclosure of information to the board to enable the board to make informed decisions (and ultimately discharge their duties).[116]

9.11 Peter Warne, the chair of Macquarie Group, has stated that this Banking Report is a warning to governors. "We need to continue to challenge, to have a much bigger emphasis on compliance and to be 100 per cent sure we are doing the right thing, and not just assuming because we have policies and procedures in place that we are complying with the law," says Warne.

9.12 Governance: Commissioner Hayne emphasized the importance of Board receiving adequate information and challenging management, and used failings by CBA (who did not do enough to ensure that management fixed issues in a timely manner) and NAB (whose board did not receive adequate information and who did not do enough to ensure that management fixed issues when the board became aware of them) as examples. Commissioner Hayne did caution boards, however, against seeing this guidance as a need for the board to become involved in day-to-day management – the task of the board is still governance, not management.

9.13 Organizational culture: Commissioner Hayne noted that culture cannot be legislated, but is important all the same and needs to be led by the governors. While there is no best practice for creating a desirable culture, Hayne says one necessary aspect is adherence to six basic norms that have now been widely quoted:

9.13.1 Obey the law;

9.13.2 Do not mislead or deceive;

9.13.3 Act fairly;

9.13.4 Provide services that are fit for purpose;

9.13.5 Deliver services with reasonable care and skill; and

9.13.6 When acting for another, act in the best interest of that other.[117]

9.14 *Remuneration*: Remuneration is related to culture, as it communicates to staff what their organisation values – this can either be affirming or demoralizing. In the Banking Report,

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[115] Australian Institute of Company Directors, *Key Findings from the Banking Royal Commission Final Report* (1 March 2019) <https://aicd.companydirectors.com.au/membership/company-director-magazine/2019-back-editions/march/royal-commission>.
[116] Ibid

[117] [117] Australian Institute of Company Directors, *Key Findings from the Banking Royal Commission Final Report* (1 March 2019) <https://aicd.companydirectors.com.au/membership/company-director-magazine/2019-back-editions/march/royal-commission>.

Hayne stated that “remuneration both affects and reflects culture”. Boards need to consider their level of involvement in remuneration decisions (and the behaviors that they drive) and inject themselves more if necessary.[118]

- END -

[118] Ibid.