



**Fifth Annual Not for Profits and Charities  
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**Title: Trustee and Directors' Duties –  
Ensuring Compliance 24/7**

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Fifth Annual Not for Profits and Charities Regulatory Conference Thursday 11 and Friday 12 May 2017 The Langham Hotel, Melbourne Speaker: Matthew Turnour, Chairman, Neumann & Turnour Lawyers, Brisbane Session 2: 10.05 - 11.05 am Title: Trustee and Directors' Duties - Ensuring Compliance 24/7

Abstract: Directors of NFPs and trustees of charitable trusts have specific fiduciary duties. That we know. What is less clear is what is required to properly discharge these duties when managing an NFP. This session lays out the key requirements for achieving not just compliance but performance 24/7.

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## Introduction and a road map

The common law and equitable principles that underpin the statute law developed because we want a better society. A better society emerges if all of the sectors of society are working optimally. The not-for-profit sector, like the other sectors, functions optimally if it has good governance. Sonya Beyers has explored some of the elements of that in the session that preceded this. And so we have general duties imposed upon directors and trustees and now specific legislated governance Standards applying to registered charities.

I will cover the law as it is today in Australia and will address some of the more complex legal challenges facing those thinking about compliance with directors and trustees duties. My primary focus though, and my brief, is to help NFPs achieve compliance 24/7. In fact what I really want is not compliance 24/7 but performance 24/7 and performance at a very high level by NFPs across Australia. That is what will make a better society.

The legal duties can be technical and complicated in the detail. There will be times when it is necessary to retain lawyers to obtain quite detailed, sophisticated advice on issues. Some of the difficulties arise because of inadequately drafted legislation. In my opinion, though, over time, the anomalies in drafting will be sorted out. When that occurs we will find the statute law conforming more closely with social expectations. Which brings us to the social expectations which are usually understood as ethics - what should be done. The duties and governance standards make sense when viewed in a broader ethical context. So I will introduce what I think are the two ethical principles underpinning this body of law.

Ethic obligations arise in a particular matrix of facts. For an organisation to behave ethically it must do so within its unique context having regard to its own narrative and identity. I call this the organisation's 'lore'. Once there is understanding of the entity's identity and its social context, located in the ethical expectations placed upon it, then the elements for good governance can be put in place. Good governance decisions lead to action by the NFP that is not only compliant 24/7 but best-practice performance. The broader point that I make then, is that 24/7 compliance is a five step process not just a knowledge of law involved. It involves:

1. Knowing yourself as an NFP (your 'lore');
2. Understanding the ethical context and obligations imposed by society;
3. Appreciating the legal obligations in this broader context;
4. Developing a framework for Good Governance decisions in light of 1 to 3;
5. And consequently developing compliant actions 24/7 - but as an expression of naturally performing in an integrated way at a very high level.

So the paper begins with an understanding of the organisation itself. That identity finds expression in a broader social context that gives rise to bodies of law, and so over the second and third sections of the paper develop an understanding of the ethics on which law rests and then turn to law. As knowledge of law is not enough to achieve compliance 24/7 I turn to governance in the section that follows and then turn to how governance decisions can be driven through into compliance 24/7. My hope in doing so is not to achieve just compliance 24/7, though, but to develop a society of high performing NFPs. High performing NFPs lead to a better society.

## The beginning is the identity and the constituent documents

One of the things that consistently surprises me, is the failure of people to read their constituent documents. The failure of people to read their company's constitution or trust deeds is a common problem. I would estimate that at least 80% of NFP disputes in which I am involved as a lawyer, and a similar percentage of court cases, are resolved on the wording of the constituent documents so I cannot underscore too heavily the importance of knowing and understanding the constituent documents that establish your NFP. But knowing the documents is but a part of a broader agenda of knowing and understanding your organisation. Understanding your organisation involves more though than just the Constituent documents. It involves understanding its identity, its narrative and its context. It involves coming to terms with why the organisation exists. What is its purpose? Who are its stakeholders - beneficiaries, members, funders and regulators? What is its vision of itself and its hope? What is its mission? What is its strategic direction? Understanding an organisation is an holistic inquiry. It begins, usually with the constituent documents but goes well beyond them. For convenience I bundle all of this under the term 'lore'.

## Understand the ethics and you will understand the law

### Law floats in a Sea of ethics

'In civilized life, law floats in a sea of ethics' declared Earl Warren, then Chief Justice of the Supreme Court of the United States in a speech in 1962.<sup>1</sup> Once that ethics is appreciated, law makes so much more sense. The key to understanding is to not get lost in the forest of technicalities. For a charity to focus on the details of the law can be a little like the trip Merry and Pippin made into Fangorn Forest.<sup>2</sup>

### Duties in history

The duties of Directors and Trustees cannot be understood as standalone concepts. Understood, as expressions of deeply shared western ethics all the (sometimes quite complicated) rules make sense, so ethics provides a map to navigate the forest of the law.

All of the rules are the application of a universally accepted ethical precept applied in a uniquely western way. The universal precept is that we are to treat others the way we would like to be treated. This precept can be found across almost all major religions and almost all moral frameworks. The uniquely western way it is applied is that once certain relationships arise in situations of trust, priority is given to the vulnerable trusting person not family and friends. The more someone has to trust us the greater our duty is to serve them. The greater the vulnerability the greater the duty taken on when holding property on behalf of or for another. In most cultures the duty is to look after family and friends first and then there is a decreasing duty as persons become more remote from us. Not so in our culture.

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<sup>1</sup> Earl Warren, (11 November 1962) *The Louis Marshall Award Dinner of the Jewish Theological Seminary*, Americana Hotel, New York City, cited in Anita L. Allen (2006) Anita L. Allen (2006) *Moralising in Public* citing Fred J. Cook, 'The Corrupt Society: A Journalist's Guide to the Profit Ethic', 196 *The Nation* 453, 454 (1963) available at [https://law.hofstra.edu/pdf/Academics/Journals/LawReview/lrv\\_issues\\_v34n04\\_i02.pdf](https://law.hofstra.edu/pdf/Academics/Journals/LawReview/lrv_issues_v34n04_i02.pdf) accessed 6 March 2016.

<sup>2</sup> JRR Tolkien, *The Lord of The Rings, The Two Towers* (1965) 74-109.

## The golden rule and vulnerability

In our ethical tradition, if a person takes upon themselves a responsibility as a trustee or director then they are in a powerful position viz a viz the members/stakeholders of the company or the beneficiaries of the trust. The law will ensure that the trustee or director applies assets entrusted to their stewardship for the purpose or person for whom they are entrusted. Put in the negative, the law will ensure that the assets are not applied for the trustee or director's own benefit or the benefit of their family or friends. By receiving assets from another the other is placed in a vulnerable position and the law can be enlivened to protect the vulnerable. The duty to treat others as we would wish to be treated tends to be understood as a form of deontological ethics and can be consistent with virtue ethics. As we shall see from recent research by Fred Kiel discussed at the end of this paper, it can be justified from a consequentialist ethical frame. It is beyond the scope of this paper to explore different ethical frameworks but I wish to acknowledge the different approaches.

This ethical principal of treating others as we would wish to be treated, applied in this way with special priority where there is vulnerability, has been part of NGO law for as long as we have legal records. The most well-known expression in the western tradition on which charity law is based is known as the *Preamble to the Statute of Elizabeth*. What is not always well known is that the *Statute of Elizabeth* was a piece of legislation passed to ensure that charitable assets were applied to charitable purposes. It was recognised that when assets were left to trustees for charitable purposes there was the risk that the Trustees would apply those assets to their own purposes rather than the charitable purpose for which they were intended. The Statute appointed commissioners to travel about the English countryside to ensure that trustees of charitable trusts applied the charitable assets to charitable purposes.

In those days trusts were the most common way of alienating assets for particular purposes, including for charitable purposes. Over the 400 years since the enactment of the *Statute of Elizabeth*, corporations have become a significant part of our lives. So, as you would expect, corporations are also used for the pursuit of charitable purposes. It is to be expected that similar rules would evolve in relation to corporations as for trustees and in fact that is what has happened.

Over the centuries the courts exercising both common law jurisdiction and equitable jurisdiction developed rules to ensure that both directors and trustees carried out the duties that they owed. There evolved sophisticated common law rules and quite nuanced equitable principles to give voice to these duties. All of those rules and principles make sense when it is understood that the purpose of the law is to give voice to an underlying ethical understanding that directors and trustees must treat the others as they would wish to be treated if the roles were reversed, and second, that the greater the vulnerability the more likely it is that the duty will arise. So we come now to the expression of these in statute.

## The Codification of the duties in the Corporations Act 2001

### Summary of the duties

In the 20th century it became common to reduce law to statute. This is so whether the law in question prohibits conduct, prescribes conduct or is procedural (such as a right to sue). The common law rules had become quite sophisticated and the equitable principles quite nuanced. It was considered helpful if these rules and principles were reduced to a distilled statutory form.

The most well-known of that form is the provisions of the Corporations Law 2001 s. 180, 181, 182, 183, 184 and 191.

Even if your charity is not a company limited by guarantee or other company regulated by the Corporations Law 2001 it is almost certainly the case that principles similar to those set out in those sections apply to your charity. Similarly if your entity is not a charity but simply a not-for-profit organisation, again the principles are still likely to apply if there is vulnerability. This is because of the existence of a relationship of trust in its broadest sense - that is where people have entrusted to the NGO assets to pursue particular NGO purposes. This broad statement is contestable but I trust that by the end of this paper it will be clear why I am of the view that this is so.

ASIC provides a tidy summary of the general duties of directors in the following way:

General duties imposed by the Corporations Act on directors and officers of companies include:

- the duty to exercise your powers and duties with the care and diligence that a reasonable person would have which includes taking steps to ensure you are properly informed about the financial position of the company and ensuring the company doesn't trade if it is insolvent
- the duty to exercise your powers and duties in good faith in the best interests of the company and for a proper purpose
- the duty not to improperly use your position to gain an advantage for yourself or someone else, or to cause detriment to the company, and
- the duty not to improperly use information obtained through your position to gain an advantage for yourself or someone else, or to cause detriment to the company.<sup>3</sup>

### The turning off of the director's duties provisions

In conjunction with the establishment of the ACNC the duties of charity directors under the *Corporations Act* were to be 'turned off'. It is my view that the turning off of the director's duties provisions by *Corporations Act* s111L has been ineffective. I say that because the wording of the introduction to the part and the section itself does not say that the duties do not apply to directors. The wording states that it only applies to the charity itself not to the directors. The introduction to the part is as follows:

#### **CORPORATIONS ACT 2001 - SECT 111K**

#### **Bodies corporate registered under the Australian Charities and Not-for-profits Commission Act 2012**

This Part applies to a body corporate that:

(a) is registered under the *Australian Charities and Not-for-profits Commission*

Act 2012; and (b) is none of the following:

- (i) a Commonwealth company for the purposes of the *Public Governance, Performance and Accountability Act 2013*,
- (ii) a subsidiary of a Commonwealth company for the purposes of that Act;
- (iii) a subsidiary of a corporate Commonwealth entity for the purposes of that Act.

The relevant section, setting out the 'turning off' so far as is relevant provides:

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<sup>3</sup> ASIC (23 March 2016) *Directors - What are my duties as a director?* at: <http://www.asic.gov.au/regulatory-resources/insolvency/insolvency-for-directors/directors-what-are-my-duties-as-a-director/#1>

## CORPORATIONS ACT 2001 - SECT 111L

### Provisions not applicable to the body corporate

(1) A provision of this Act mentioned in the following table does not apply to the body corporate, subject to any conditions prescribed by the regulations for the purposes of this [subsection](#) in relation to the provision:

Provisions of this Act that do not apply to bodies corporate registered under the ACNC Act		
Item	Column 1	Column 2
	Provision(s)	Topic
1	<a href="#">subsection 136(5)</a>	Public company must lodge with ASIC a copy of a <a href="#">special resolution</a> adopting, modifying or repealing its constitution
2	<a href="#">section 138</a>	ASIC may direct company to lodge consolidated constitution
3	<a href="#">section 139</a>	Company must send copy of constitution to member
4	<a href="#">subsection 142(2)</a> , <a href="#">section 146</a> and <a href="#">subsection 146A(2)</a>	Company must notify ASIC of changes of address
5	(a) <a href="#">sections 180</a> to <a href="#">183</a> ; and  (b) <a href="#">section 185</a> , to the extent that it relates to <a href="#">sections 180</a> to <a href="#">183</a>	Duties of <a href="#">directors</a> etc.
6	<a href="#">section 188</a> , to the extent it relates to a provision mentioned in another item of this table	Responsibility of secretaries and <a href="#">directors</a> for certain contraventions
7	<a href="#">sections 191</a> to <a href="#">194</a>	Interests of <a href="#">directors</a>
8	(a) <a href="#">sections 201L</a> and <a href="#">205A</a> to <a href="#">205C</a> ; and  (b) <a href="#">section 205D</a> , to the extent it relates to <a href="#">section 205B</a> ; and  (c) <a href="#">section 205E</a>	Public information about <a href="#">directors</a> etc.
9	(a) Part 2G.2 (other than <a href="#">sections 250PAA</a> and <a href="#">250PAB</a> ); and  (b) Part 2G.3, to the extent that it relates to meetings of the	Meetings of members



Provisions of this Act that do not apply to bodies corporate registered under the ACNC Act		
Item	Column 1	Column 2
	Provision(s)	Topic
	body corporate's members	
10	(a) Parts 2M.1 and 2M.2; and (b) Part 2M.3	Financial reports and audit
11	Chapter 2N	Updating ASIC information about companies and registered schemes
12	<a href="#">sections 601CDA, 601CK and 601CTA</a>	Foreign companies
13	<a href="#">subsection 601CT(3), section 601CV and subsections 601DH(1) and (1A)</a>	Registered body must notify ASIC of certain changes

It is my view that this was almost certainly an oversight and it is likely to be rectified when the legislation is reviewed.

## The ACNC Scheme

### The ACNC Objects

The *ACNC Act* has established an administrative agency for the NFP sector. The statutory objectives of the ACNC are set out in the following terms:

- (a) to maintain, protect and enhance public trust and confidence in the Australian not-for-profit sector;
- (b) to support and sustain a robust, vibrant, independent and innovative Australian not-for-profit sector; and
- (c) to promote the reduction of unnecessary regulatory obligations on the Australian not-for-profit sector.<sup>4</sup>

To achieve these objects regulations imposed governance standards.

### The governance Standards

The duties set out in the *Corporations Act* are set out in governance standards and (still to be published) external conduct standards which NFP entities are required to meet as a condition of registration under the Act.<sup>5</sup> All registered charities except Basic Religious Charities (BRCs) are required to comply with the governance standards.<sup>6</sup> The governance standards are vague and at times awkwardly expressed. A charitable entity is required:

- to demonstrate its purposes and character as a not-for-profit entity, to make information about its purposes available to the public, and to comply with its purposes and character as a not-for-profit entity (Governance Standard 1);

<sup>4</sup> ACNC Acts. 15-5(1)

<sup>5</sup> ACNC Act ss 25-5(3)(b), 45-10, 50-10, 200-5.

<sup>6</sup> ACNC Acts 100-5(3).

- to take reasonable steps to ensure that it is accountable to its members and that its members have adequate opportunity to raise concerns about how the charity is governed (Governance Standard 2);
- to abstain from any conduct (and to avoid any omission) that may be dealt with as an indictable offence or by way of a civil penalty of 60 penalty units or more (Governance Standard 3);
- to take reasonable steps to remove board members who do not meet these requirements (Governance Standard 4); and
- to take reasonable steps to ensure that its board members know and understand their legal duties and that they carry out some of the more significant of these duties (Governance Standard 5).

What is surprising to the uninitiated is that Governance Standard 5 which seems to deal with directors and trustees duties imposes the duty on the charity not its leaders. For those not familiar with the Commonwealth parliament's limited powers, this does not make sense. Essentially constitutional limitations drive the form of drafting because the commonwealth may have power to regulate charities but not directors.

### Governance Standard 5

The *Corporations Act* duties summarised above are, in effect, imported and imposed through Governance Standard 5 but, and this is an important qualification, the wording is not the same. Governance Standard 5 is in the following terms:

#### AUSTRALIAN CHARITIES AND NOT-FOR-PROFITS COMMISSION REGULATION 2013 - REG 45.25

##### **Governance standard 5--Duties of responsible entities**

###### Object

- (1) The object of this governance standard is:
  - (a) to ensure that the responsible entities of a registered entity conduct themselves in the manner that would be necessary if:
    - (i) the relationship between them and the entity were a fiduciary relationship; and
    - (ii) they were obliged to satisfy minimum standards of behaviour consistent with that relationship; and
  - (b) to give the public, including members, donors, employees, volunteers and benefit recipients of a registered entity, confidence that the registered entity:
    - (i) is acting to prevent non-compliance with the duties imposed on responsible entities; and
    - (iii) if non-compliance with the duties imposed on responsible entities occurs--will act to identify and remedy non-compliance with the duties imposed on the entity.

###### 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](#).

Note 1: Governance standard 5 sets out some of the more significant duties of responsible entities. Other duties are imposed by other Australian laws, including the principles and rules of the common law and equity.

Note 2: Some of the duties imposed by other Australian laws may require a responsible entity to exercise its powers and discharge its duties to a higher standard.

Note 3: For [paragraph](#) (f), ensuring that the registered entity's financial affairs are managed in a responsible manner includes putting in place appropriate and tailored financial systems and procedures.

The systems and procedures for a particular registered entity should be developed having regard to the registered entity's size and circumstances and the complexity of its financial affairs.

The systems and procedures may include:

(a) procedures relating to spending funds (for example, the approval of expenditure or the signing of cheques); and

(b) having insurance that is appropriate for the registered entity's requirements.

(3) For [paragraph](#) (2)(e), a perceived or actual material conflict of interest must be disclosed:

(a) if the responsible entity is a director of the registered entity--to the other directors (if any); or

(b) if the registered entity is a trust, and the responsible entity is a director of a trustee of the registered entity--to the other directors (if any); or

(c) if the registered entity is a company--to the members of the registered entity; or

(d) in any other case--unless the Commissioner provides otherwise, to the Commissioner, in the approved form.

Note 1: **Company** is defined in section 205-10 of the Act, to include a body corporate or any unincorporated association or body of persons (but not a partnership).

Note 2: [Paragraph](#) (c) applies in situations where [paragraph](#) (a) cannot apply, for example, if there is only one director or all the directors have a similar conflict.

Note 3: Part 7-6 of the Act provides for the approval of forms.

Note 4: A responsible entity may disclose a conflict of interest in the form of a standing notice with ongoing effect.

(4) If the responsible entity's conduct is consistent with Subdivision 45-C, the responsible entity is taken to have complied with the duties mentioned in [subsection](#) (2).

(5) In this section:

**"insolvent"** has the meaning given by [subsection](#) 95A (2) of the [Corporations Act 2001](#) .

Reviewing the impact of this enactment and its difference from the *Corporations Act* Ian Ramsay and Miranda Webster conclude an article stating that the publication of the Governance Standard 5 has led to 'increased complexity in the governance arrangements of registered charities and reduced accountability in various ways'.<sup>7</sup> I agree with Ramsay and Webster that the governance standards have 'increased complexity in the governance arrangements of

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<sup>7</sup> Ian Ramsay and Miranda Webster, (2017) *Registered Charities and Governance Standard 5: an Evaluation*, 45 ABLR 127 at 158

registered charities'.<sup>8</sup> It will become evident from this paper that I do not believe that the overall effect of the ACNC Governance Standards is to reduce 'accountability in various ways'.<sup>9</sup>

I am of the view that a court will treat the governance standards as a minimum statutory standard not an abrogation of the common law standards for both trustees and directors. Even if they are an attempt at a codification intended to cover the field I do not think a court will allow persons who owe duties to the organisation to find ways of weaselling out, based on errors in drafting. It follows that I think most of the time the duties are higher at common law and in equity than under the governance standards. I say most of the time because much will turn on the facts and in my view the common law, equitable principle or governance standard, as the case may be, will be given a nuanced application according to context having regard to the trust relationships and the vulnerabilities inherent in the situation. Where there is law, trust and no vulnerability and a group of inexperienced do-gooders fail technically but the social intent is achieved and there was not any injury to vulnerable people then the over-arching ethics not the brutal technicality of the law is likely to find expression in judgments. By contrast I am of the view that in sufficiently dastardly circumstances, equitable tracing rules will be enlivened to recover misapplied charitable funds and they go well beyond these duties.

## The duties as they apply to trustees and the Trusts Act

### The State trusts Acts

The State trusts Acts spell out the duties just discussed but also significantly empower trustees. I take the Queensland Act as illustrative. The first general point to make is that the intention of the Trusts Act 1973, is to provide reasonable protection to trustees provided they are acting in accordance with standards set out in that legislation. So in the *Queensland Trusts Act 1973* Parts 3, 4, 5 and 6 first sets out powers and duties and then provides certain rights to trustees which cannot be over-riden by the Trust Deed. By way of summary of the position, the *Trusts Act 1973* allows for broad powers of investment and provided the trustee fulfils the statutory obligation to 'exercise the care, diligence and skill a prudent person engaged in that profession, business or employment would exercise in managing the affairs of other persons', protection for investment decisions made is available. It should also be noted that subsequent provisions of the *Trusts Act 1973* import the pre-existing law and equitable principles.

As an example of the way the *Trust Act* empowers trustees, take the way that the general investment power in Part 3 of the *Trusts Act 1973* (Qld) enables trustees to apply the modern portfolio theory of investment.

### The position at Common law and in equity

The common law and equitable position is consistent with the statutory principles expounded to this point. The cases on trustees and the Trusts Acts in each of the States are not as clear as the *Corporations Act 2001*. In this section I set out a summary of the law as I believe it to be in Australia today.

I start with the courts setting parameters within which trustees may exercise discretion. There is considerable latitude for a trustee in exercising a discretion provided they do so within

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<sup>8</sup> Ian Ramsay and Miranda Webster, (2017) *Registered Charities and Governance Standard 5: an Evaluation*, 45 ABLR 127 at 158

<sup>9</sup> Ian Ramsay and Miranda Webster, (2017) *Registered Charities and Governance Standard 5: an Evaluation*, 45 ABLR 127 at 158

constraints. The academic Lisa Butler summarised the law regarding trustee discretions at the close of the last century with the statement: "From the earliest times, judges have reiterated the notion that a trustee's exercise of discretion is considered an almost sacrosanct power examinable only upon evidence of mala fides".<sup>10</sup> The common articulation of the principles applicable in Australia is that set out by the Victorian Judge, McGarvie J. in *Karger v Paul* where his Honour held:

In my opinion the effect of the authorities is that, with one exception, the exercise of an absolute and unfettered) discretion ... will not be examined or reviewed by the courts so long as the essential component parts of the exercise of the particular discretion are present. Those essential component parts are present if the discretion is exercised by the trustees in good faith, upon real and genuine consideration and in accordance with the purposes, for which the discretion was conferred. The exception is that the validity of the trustees' reasons will be examined and reviewed if the trustees choose to state their reasons for their exercise of discretion. In this context | consider that the test of acting honestly is the same as the test of acting in good faith: compare: all Holl (1881) 7 QBD 575, at pp. 580-1, per Bramwell LJ. It was argued for the plaintiff that gross negligence may of itself amount to an absence of good faith. I do not agree. Honest blundering and carelessness do not of themselves amount to bad faith: Jones v Gordon (1877 2 AC 616, at pp. 628-9, per Lord Blackburn. Again do not agree with the argument for the plaintiff that there is any conceptual territory which lies between good faith and bad faith. An act which falls short of good faith is done in bad faith.<sup>11</sup>

This principle was summarised and applied recently in Queensland by Henry J in *Foley v Gleeson* where it was held in the context of a testamentary trust granting discretions that "...the trustees have a duty to exercise that discretion in good faith, upon real and genuine consideration".<sup>12</sup>

*Karger v Paul* was discussed but distinguished by the High Court in *Finch v Telstra Super*.<sup>13</sup> Obiter, the Court observed that:

There is no doubt that under *Karger v Paul* principles, particularly as they have been applied to superannuation funds, the decision of a trustee may be reviewable for want of "properly informed consideration". If the consideration is not properly informed, it is not genuine. The duty of trustees properly to inform themselves is more intense in Superannuation trusts in the form of the Deed than in trusts of the *Karger V Paul* type ... It would be bizarre if knowingly to exclude relevant information from consideration were not a breach of duty. And failure to seek relevant information in order to resolve conflicting bodies of material, as here, is also a breach of duty. ... Whether or not it will be decided hereafter that, ... the duty of a superannuation trustee in forming an opinion of the present type is a duty to form a fair and reasonable opinion, or even a duty to form a correct opinion, there is because of the importance of the opinion and its place in the total and permanent disability payment) scheme a high duty on the Trustee to make inquiries for "information, evidence and advice" which the Trustee may consider relevant. The existence of that duty in a more intense form than exists under *Karger v Paul* principles in their standard application is further support for the correctness of Byrne J's decision.<sup>14</sup>

*Karger v Paul* and *Foley v Gleeson* involved private trusts, and *Finch* involved a nondiscretionary duty. What then is the position of a charity trustee? The trustee of a charitable

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<sup>10</sup> Lisa Butler, 'The legitimate Bounds of a Trustee's Discretion' (1999) 11(1) *Bond University Law Review* 14.

<sup>11</sup> [1984] VR 161, 164.

<sup>12</sup> *Foley v Gleeson and Ors* [2013] QSC 234, [57].

<sup>13</sup> *Finch v Telstra Super* (2010) 271 ALR 236, 252-254.

<sup>14</sup> *Finch v Telstra Super* (2010) 271 ALR 236, 254 underlining added.

trust has, I suggest at the least 'a duty to exercise that discretion in good faith, upon real and genuine consideration'.<sup>15</sup> But is there more? The high standard of Finch almost certainly does not apply to most charitable trusts as most are both discretionary and charitable. What is to be made of the High Court's obiter comments, though, in the context of charitable trusts? Charitable trusts are public purpose trusts. Charities are increasingly the subject of public scrutiny and a purpose of establishing the ACNC was to enable that public scrutiny.<sup>16</sup> I raise the possibility that the standard expected of charity trustees may be higher than that set out in *Karger v Paul* and *Foley v Gleeson*. This is even more likely if cognizance is taken of developments in England.

In England there has been a recent restatement of the duties of trustees of charitable trusts as the issue arose for consideration in the *Independent Schools* case.<sup>17</sup> In that case the Court explained:

This is all a matter of judgment for the trustees. There will be no one right answer. There will be one or more minimum benefits below which no reasonable trustees would go but subject to that, the level of provision and the method of its provision is properly a matter for them and not for the Charity Commission or the court. We deliberately avoid using the word "reasonable". In a similar context, see Sir Nicolas Browne-Wilkinson V-C. in *Imperial Group Pension Trust Ltd v. Imperial Tobacco* (1999] 1 W.L.R. 589 when he effectively created the obligation of good faith owed by employers to beneficiaries in the context of their activities in relation to a pension scheme. It is not for the Charity Commission or the Tribunal or the court to impose on trustees of a school their own idea of what is, and what is not, reasonable. The courts have never done that in the context of their supervision of trustees of private trusts and the same should apply to charities. ... There is always a range of actions which they can take in a given situation. There is, of course, a limit outside which they must not step. But the identification of that limit is not based on a test of reasonableness. We recognise that this does not provide any sort of black-letter test by which the Charity Commission or trustees of schools can know which side of the line the School falls. But this is not to create a novel sort of difficulty but to recognise that constraints on the behaviour of classes of person can often involve concepts which are easy to state but difficult to apply in practice, as is seen so often in cases of alleged breach of trust or in the application of the Imperial Tobacco duty.<sup>18</sup>

### My views

I respectfully concur with the view expressed that the same principles as apply for private trusts apply for charitable trusts, but given the clear demarcation of outer limits, which are acknowledged as hard to map, I hesitate to simply recommend the *Karger v Paul* formulation as restated by Henry J in Queensland. Though technically charities are private trusts they are established for public benefit so there may be a 'limit outside which [a charitable trustee] must not step' that falls short of a 'test of reasonableness'.

Reframing the *Independent Schools* decision for Australia, it might be that there are decisions about distributions which a trustee could make that technically falls within the scope of the terms of the charitable trust but that no reasonable trustee would make. It might be that this idea is caught up in the Australian formulation of *Karger v Paul* and is simply another way of saying

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<sup>15</sup> *Foley v Gleeson and Ors* [2013] QSC 234, [57].

<sup>16</sup> See *Australian Charities and Not-for-Profits Commission Act 2012* (Cth) Part 1-2, Div 15-5.

<sup>17</sup> *Independent Schools Council v Charity Commission* [2011] UKUT 421 (TCC).

<sup>18</sup> *Ibid* (220) underlining added.

there is a duty to exercise that discretion in good faith, upon real and genuine consideration'.<sup>19</sup> It could be, though, that the English case of the *Independent Schools* mentioned is a more comprehensive statement of the boundaries within which charity trustee discretions must be exercised. It might also be that trustees must take particular note of the obiter comments of the High Court in *Finch v Telstra Super*. There may be a higher obligation on a charity trustee. That duty may be to go to greater lengths to identify relevant facts and be 'properly informed' and that may mean not bizarrely excluding 'relevant information from consideration'. Furthermore it may well be very difficult to know just where that boundary lies. Accordingly I am not fully persuaded that in the case of a charitable trust in Australia today that a decision by trustees would not be over-turned by a court on application of the ACNC or anyone with standing to sue even though the decision was made by the trustees in good faith, upon real and genuine consideration and in accordance with the purposes for which the discretion was conferred'. I would look for evidence that 'the consideration is not properly informed' or not 'genuine', or that the trustees 'knowingly chose to exclude relevant information from consideration'. I would look to see if this was a decision or conduct beyond 'a limit outside which charitable trustees must not step'.

## Duties of directors of Companies when changing purposes

Let me move now into some very difficult territory. I now set out some further developments in understanding the law in relation to the duty of directors or charitable companies when changing purposes. It will be helpful if I state at the outset my conclusion. My view is that the directors of charity corporations can change the purposes of a company but they cannot repurpose assets received for charitable purposes without breach of trust-like obligations. Appreciating this nuanced position requires explaining the law in some detail.

### Professor Jaffey's thoughts

Professor Peter Jaffey in a paper titled: 'Explaining the Trust' published in the July 2015 edition of *Law Quarterly Review* takes up the 'long-standing controversy over the nature of the trust'.<sup>20</sup> In his view the distinction between equity and common law in this context is 'relevant only to an historical account of the Trust' and that 'a principled account' is required if the law is to be appropriately developed.<sup>21</sup> After explaining the two rival theories: the obligation theory and the proprietary theory, he points out that:

Just as the obligational theory cannot account for the proprietary aspect of the trust, so the proprietary theory cannot account for the duty of an express trustee to look after and distribute the trust property.<sup>22</sup>

Where this argument leads Jaffey is to the view that the formation of a trust involves two distinct legal events:

(1) the allocation of property rights in the trust property arising from the declaration of trust by the settlor, and (2) the undertaking by the trustee to hold the trust property and distribute it to give effect to this allocation of property rights.<sup>23</sup>

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<sup>19</sup> *The Independent Schools* case was handed down in 2011 and so far as we can discern it has not been considered in Australia. It was not cited in *Bargwana*.

<sup>20</sup> L.Q.R. 2015, 131 (Jul), 377-401 at 377

<sup>21</sup> L.Q.R. 2015, 131 (Jul), 377-401 at 377

<sup>22</sup> L.Q.R. 2015, 131 (Jul), 377-401 at 393

Jaffey turns to apply this distinction to charitable trusts observing:

In the case of a charitable trust, there are no beneficiaries with individual property rights, and in the property dimension one can say that the property is bound to the charitable purpose. In the contractual dimension, the trustee's duty to carry out the trust is enforceable by the Attorney General. Under a private purpose trust, there are no true beneficiaries with property rights in the trust property. In the property dimension, the property is bound to the purpose stipulated. In a *Re Denley* purpose trust, the trustees are subject to a duty in the contractual dimension to carry out the trust, and there are "factual beneficiaries" who have no property rights but do have the power in the contractual dimension to enforce the trustees' duty because they will directly benefit from the performance of the trust.<sup>24</sup>

In the Endnote to this section Jaffey explains the significance of the distinction. He states:

*Re Denley* (1969] 1 Ch. 373; 1968) 3 All E.R. 65. Thus the distinction between a *Re Denley* purpose trust and a discretionary trust is whether there are true beneficiaries with property rights, as opposed to "factual beneficiaries". On the suggested analysis, a "factual beneficiary" does not have an equitable proprietary claim in their own right, but the trustee should be able to recover trust property invalidly transferred and the factual beneficiaries should be able to compel the trustee to act.<sup>25</sup>

*Re Denley* involved a conveyance of land for use as a sports ground "primarily for the benefit of the employees of the company and secondarily for the benefit of such other person or persons (if any) as the trustees may allow to use the same ...".<sup>26</sup> It was common ground that a gift of land for use as a sport and recreation ground for employees was a gift for a non-charitable purpose in that jurisdiction. Even so it was held to be a valid purpose trust by Goff J who opined:

I think there may be a purpose or object trust, the carrying out of which would benefit an individual or individuals, where that benefit is so indirect or intangible or which is otherwise so framed as not to give those persons any locus standi to apply to the court to enforce the trust, in which case the beneficiary principle would, as it seems to me, apply to invalidate the trust, quite apart from any question of uncertainty or perpetuity.<sup>27</sup>

## My Suggestion

I suggest that this case is authority for the proposition that a purpose trust in which a person has no (equitable) proprietary interest is still valid, provided someone has standing to sue to enforce its terms. If that is so, then it seems the proposition can be put in reverse, that is, that: a trustee of a purpose trust can be compelled to perform in accordance with the terms of the trust by a person not having a proprietary (equitable) interest. Simplified even further, the non-statutory position may be that a person who does not have to have an equitable interest, proprietary or

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<sup>23</sup> Ibid 393 usefully citing the following sources in footnote 48 to this text: An earlier version is in *Jaffey, Private Law and Property Claims* (2007), Ch. 5. See also Palmer, "Theories of the Trusts and What They Might Mean for Beneficiary Rights to Information" (2010) N.Z.L.R. 541;

Nolan, "Equitable Property" (2006) 122L.Q.R. 232. Virgo refers to two components of the trust, but these are (1) the ownership of the trust property by the trustee and (2) the duty owed by the trustee in respect of the trust property: see *Virgo, The Principles of Equity & Trusts* (Oxford: Oxford University Press, 2012). See also Parkinson, "Reconceptualising the Express Trust" (2002 C.L.J. 657; Gardner, "Persistent Rights Appraised" in Hopkins (ed.), *Modern Studies in Property Law, Volume 7* (2013), at pp.347-349.

<sup>24</sup> Ibid 393

<sup>25</sup> L.Q.R. 2015, 131(Jul), 377-401 at endnote 51

<sup>26</sup> Denley's Trust Deed [1969] 1 Ch 373 at 375 - 376

<sup>27</sup> Denley's Trust Deed [1969] 1 Ch 373 at 382-383



otherwise, may seek orders in equity to compel a trustee of a purpose trust to perform obligations arising out of or incidental to that trust, provided they have standing to sue.

### Standing to Sue

Locus standi or put simply the right to sue on a charitable trust is an interesting issue in Australia. Queensland has a provision in its *Trusts Act 1973* s 106(2)(b) granting locus standi to 'any person interested in the due administration of a charitable trust' as well as the Attorney-General or person authorised by the Attorney-General; and the charity, or any trustee of the trust'.<sup>28</sup> Reasoning from the *Re Denley* position, a Queensland court could hold, I suggest, that a trustee or more contentiously, a corporation taking funds on a charitable basis, can agree to perform in certain ways, in addition to its obligations under the trust, or more contentiously, the expressed objects in a company constitution without any additional trust interest or trust obligation being created. Any person relying upon any such enforceable representation or any agreement struck, may well have locus standi but they do not necessarily have anything more - nor need they. This may be very important for the development of this body of law. Particularly where there is fundraising by a trustee of a general trust, say a community foundation, for particular projects. And, more contentiously, a company with charitable but not necessarily exclusively charitable objects. Essentially the issue is, whether a court can and should in appropriate cases enforce promises or agreements ostensibly for charitable purposes if there is not a formal trust. The *Re Denley* position suggests that in some cases a court can. On the question of whether a Court should, one of Australia's leading thinkers in both equity generally and charity law in particular, has turned his mind to this question. Prof. Matthew Harding of Melbourne University in a paper published in the *Oxford Journal of Legal Studies* set out a theoretical basis for development of the law in this way. Writing from a liberal philosophic perspective he suggests:

In a state committed to liberal philosophical principles, I think it is important that fiduciary law serve this purpose of enabling detached relationships that mimic trusting relationships in addition to its purpose of enabling trusting relationships themselves.

Explaining this further he stated:

Certainly, building a trusting relationship as a normative framework for cooperative action is a powerful expression of the autonomy of the parties to the relationship, and to the extent that fiduciary law assists in making this possible it serves liberal ends. But equally expressive of autonomy is the choice of cooperative action on terms other than those offered by trust, and indeed on terms that reject the Creative potential of trust. Given the creative potential of trust, a choice on terms of detachment is always, in a sense, a matter for regret; to my mind this is a reason for fiduciary law, where appropriate, to emphasize its goal of enabling trusting relationships over its goal of enabling detached cooperation. Nonetheless, if only because in some circumstances, terms of detachment might be only ones realistically available.<sup>29</sup>

Turning to the Australian case law, Young CJ in *Equity*, expressed the view obiter that the 'majority view is that [Re: Denley's Trust Deed] was wrongly decided' but provided no reference

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<sup>28</sup> *Trusts Act (Queensland)* s.106(2). It is my understanding that the other jurisdictions that may have this are Western Australia and New Zealand. There is an interesting question whether such a power might be found in other states under the general trust powers in light of this analysis.

<sup>29</sup> Matthew Harding (2013) "Trust and fiduciary law *Oxford Journal of Legal Studies*, Vol. 33, No. 1 pp. 81102, 102

or authority for the observation.<sup>30</sup> McMurdo J applied *Re: Denley* to a discretionary trust for 'grandchildren' in *Yeomans v Yeomans* but that was not a charitable trust inquiry nor was that case expressly on a point in question here.<sup>31</sup> Lindgren J also applied *Re: Denley* in *Kafataris v The Deputy Commissioner of Taxation*.<sup>32</sup> Relevant to this inquiry he held in a discussion of the law in relation to a discretionary trust:

43) The word "beneficiary" reaches beyond a person who has a beneficial interest in the trust property. It is possible for the legal estate in land to be vested in "trustees" without equitable ownership being vested in someone else. The trustees must, however, owe fiduciary obligations in respect of the trust property to persons who, although they may have no interest in the trust property and may never have an interest in the trust property, are called "beneficiaries". In *CPT Custodian Pty Ltd v Commissioner of State Revenue of the State of Victoria* (2005) 224 CLR 98, the High Court rejected (at 25):

a "dogma" that, where ownership is vested in a trustee, equitable ownership must necessarily be vested in someone else because it is an essential attribute of a trust that it confers upon individuals a complex of beneficial legal relations which may be called ownership.

That is to say, there can be a trustee who owes fiduciary obligations in respect of trust property to "beneficiaries" without any of the latter having a beneficial interest in the property.

### My View

If the argument set out above is accepted then a Court applying the common law and equitable principles can, and should in appropriate cases, give effect to representations and agreements made by a charitable trustee or more contentiously a corporation that has accepted assets for charitable purposes. If the reasoning set out in *Kafataris v The Deputy Commissioner of Taxation* is applied from discretionary trusts to charitable trusts and from charitable trusts to charitable corporations then the right to sue granted generally to "beneficiaries" under state trusts acts may be broader than is generally conceived. A person belonging to a class of possible beneficiaries may be able to sue. So if funds are raised for victims of cyclone Debbie a victim of that cyclone may have standing to sue the trustee to apply the funds to these victims.

Courts might make orders based on the existence of enforceable common law or equitable obligations. It follows that a person or corporation in control of charitable funds may well be bound to perform its obligations as a fiduciary in a *Re: Denley* sense. There is authority and moral argument why it should. That is, though, possibly the harder road.

The possibly easier road for a person in Queensland pleading a Queensland Court to give directions or make orders is to exercise jurisdiction pursuant to the *Trusts Act* s.106(1) on application by 'any person interested in the due administration' of a charitable trust under the *Trust Act* s.106(2). This can be done without that person having any equitable interest in the property in question. The court is required only to be satisfied that the person has 'an interest in the due administration of the trust'. The expression 'trust' might need to be broadly conceived but that is not a task beyond the scope of a Supreme Court judge.

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<sup>30</sup> *Application of Marie-Louise Hendrika Van Campen-Beekman* (2007) NSWSC 916. In that case a testamentary gift to the 'Free Papua Movement an unincorporated association, was impossible to Save, on the facts.

<sup>31</sup> [2006] 1 Qd R 39

<sup>32</sup> [2008] FCA 1454

In addition to possible claims by persons belonging to the class of beneficiaries intended to benefit from the charitable gift, thought should be given to the rights of donors. Such an application would test the rights of trustees to resist claims by the funders who have no proprietary interest but do have the benefit of an obligation on the trustee to have regard to their (charitable) reason for their gift. Further the most obvious 'interested person' would perhaps be the ACNC. It is difficult to see a Queensland court denying ACNC standing to sue given its public function it would seem to be an 'interested party'.

### Directors' duties when changing a corporation's purpose

The discussion above sets up a new perspective for a discussion about the duties of directors of companies that pursue charitable purposes. Let me begin by stating the problem. We are troubled that a charity's assets held by a corporation in its own right and not as trustee could be applied to non-charitable purposes by amendment of the Objects of the company to include non-charitable purposes. We start from the premise that a company in general meeting is, and should be, allowed to amend its constituent documents. It would be a gross violation of Corporations law to stop this. We want to stop the misapplication of assets, though, so we ask what could be done to possibly inhibit a lawful right to amend its constituent documents. But what if we did not care about amendment of the company's constitution? What if a company had both charitable and non-charitable objects? We do not really care about the constitution of the company anyway. What we care about is the application of assets to the pursuit of charitable purposes. What if we acknowledged the capacity of the corporation to do what it liked with its constitution under any circumstances? How are we worse off? We are not. We are only worse off, as a society, if assets intended for charitable purposes are applied to non-charitable purposes. So the issue is not the company constitution but the application of assets of the company.

But here is the rub. The law of trusts does not extend to company constitutions and it cannot be said that the company holds the asset on trust for the purposes. That is too strong a statement. But here the analysis provided above based on the thinking of Jaffey above, helps. A charitable trust is different from a typical private trust. With a typical trust a trustee holds property on behalf of specified beneficiaries. With a charitable trust there are no specified beneficiaries. The property is held for purposes - charitable purposes. So no one has a beneficial interest. No one has a right to have the assets applied to (their) purposes because no one has a beneficial interest. So in a sense all that exists in the context of a charitable trust is an obligation on the part of the trustee. There is not a right in a beneficiary or donor to enforce the performance of the trust- or so it seems. But is this really so? I say no - based on the discussion above.

Let us develop an easy case to illustrate. A charity company limited by guarantee without express trusts registers on the Register of the ACNC with no assets. It begins a financial campaign to help victims of cyclone Debbie and raises \$10 million from the public. Assume I am a donor of say, \$1,000. The company deregisters from the ACNC, changes its objects and asset locking clauses and distributes to the members. It seems to me that I might have rights of action under the following heads of law

- (1) Criminal law for - false pretences;
- (2) Contract or quasi contract for - misrepresentation or breach of contract;
- (3) Statutory breach of duty - misleading and deceptive conduct;
- (4) Under statute or in equity for unconscionability or other breach of fiduciary duty.

I use the expression breach of fiduciary duties rather than breach of trust so as not to confuse the discussion, but in simplest terms, I placed my trust in that organisation and the organisation

betrayed that trust. If this broad understanding of trust is accepted I have standing to sue under s.106(2) in Queensland. If not I am back to *Re Denley* arguments.

What I want is my money back. If there has been a breach of an equitable duty of a fiduciary nature or any other duty that triggers the tracing laws then the payments made can be recovered from the members of the company even if the charity company has been wound up. The situation is even clearer if the company has not been wound up. Now academics can argue about the way this duty is described as trust or trust-like but really we are talking about how to regain the payment. If I can commence the action then I suspect the ACNC might be even better positioned to do so. If this is so then the ACNC might not need its powers to take control of a trust or a company that is a federally regulated entity. The argument set out above suggests that if the ACNC is willing to bring a Court application:

- (a) The ACNC might not need to rely on federal powers; but
- (b) May need some State legislation broadening power to sue, particularly in states other than Queensland.

## The Criminal Code

3. The Criminal Code of Queensland provides a number of provisions in **Chapter 42A--Secret commissions** of which it is useful to be aware.

442B Receipt or solicitation of secret commission by an agent

Any agent who corruptly receives or solicits from any person for himself or herself or for any other person any valuable consideration—

- (a) as an inducement or reward for or otherwise on account of doing or forbearing to do, or having done or forborne to do, any act in relation to his or her principal's affairs or business; or
- (b) the receipt or any expectation of which would in any way tend to influence the agent to show, or to forbear to show, favour or disfavour to any person in relation to his or her principal's affairs or business;

commits a crime.

442E Secret commission for advice given whenever any advice is given by one person to another, and such advice is in any way intended or likely to induce or influence the person advised

- (a) to enter into a contract with any third person; or
- (b) to appoint or join with another in the appointment, or to vote for or to aid in obtaining the election or appointment, or to authorise or join with another in authorising the appointment of any third person as trustee, director, manager, or official; and any valuable consideration is, without the assent of the person advised, given by such third person to the person giving the advice, the gift or receipt of the valuable consideration is a crime; but this subsection shall not apply when the person giving the advice was, to the knowledge of the person advised, the agent of such third person, or when the valuable consideration was not given in respect of such advice.

4. At section 442G it sets out grounds for director liability for acting without authority. It provides:

Liability of director etc. acting without authority Any director, manager, or officer of a company, ... or any person acting for another, who knowingly takes part in or is in any way privy to doing, or attempts to do, any act or thing without authority which, if authorised, would be in contravention of any of the provisions of this chapter, commits a crime.

In a separate chapter the Criminal Code of Queensland defines extortion in the following way:

415 Extortion (1) A person (the demander) who, without reasonable cause, makes a demand

(a) with intent to

- (i) gain a benefit for any person (whether or not the demander); or
- (ii) cause a detriment to any person other than the demander; and (b) with a threat to cause a detriment to any person other than the demander, Commits a Crime.

These and similar other State criminal laws should not be overlooked.

## What about boundaries?

So far I have spoken only about charities, companies and not-for-profits as an amorphous whole because I wanted to focus on developing an understanding of the similarities. They are of course different in their application.

### Morice v Bishop of Durham

Good works is not enough to qualify for the status of charity. One of the leading cases establishing the scope of charity, *Morice v Bishop of Durham*,<sup>33</sup> is authority for the proposition that a charity must pursue only charitable purposes. If there is a purpose other than a charitable purpose that is not incidental or ancillary then the entity cannot be a charity.

### Three implications

There are three things to say about this. It is a boundary that is increasingly challenged by social enterprises in particular, but also self-help charities and other good works entities. Second, it is surprising how widely the tax exemptions apply to entities that are not charities but are good for society. So if you are involved in an entity that is not a charity but doing good works, consider the scope of the other exemption provisions of Division 50. Third, if you are setting up a charity but are concerned about the scope of regulation of charities and could fall within another exemption head in Div 50 but for the fact that the purposes are entirely charitable consider including a non-charitable purpose in the list of purposes as a principle purpose so that you cannot get charity status but will be entitled to exemption under another head of division 50. It is my view that this loophole should be closed by bringing registration of all division 50 entities within the registration framework of the ACNC, but for so long as this option remains open, it can be utilized.

I now change gear. I move from the esoteric to the applied.

## Governance

In this section I am going to summarise the three elements that I consider essential to governance that leads to compliance 24/7. They are:

- Good **governors** pursuing
- Good **goals** within
- Good **guidelines**.

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<sup>33</sup> [1805] EWHC Ch J80

By Good **governors** I mean persons who are virtuous. And that virtue is not just of a general nature but is virtuous according to the culture of the particular organisation having regard to its identity, narrative and context. What is a virtuous governor of Greenpeace may be different from a church leader or a housing provider. Whatever the institution though, they will be people who understand and apply the duties imposed by law as set out in the governance standards.

By Good **goals** I mean the organisation is strategically pursuing objectives consistent with its stated charitable purposes. Good goals are the kind of goals that are going to make the world a better place.

By Good **guidelines** I mean clearly articulated standards which set out in a way that is consistent with the organisations identity and its community's ethics and law, appropriate parameters for the conduct of the mission of the charity.

I cannot develop these ideas here but move to how these translate into compliant actions.

## Action - 24/7 compliance

For the purpose of this paper it is enough to define compliant action as occurring within three broad areas. They are:

- Documents
- Dynamics, and
- Discipline.

By **documents** I mean the documents that give expression to the identity, of the organisation, its strategic intent, its hopes and its place in the community. I cannot overstate the importance of getting the constituent documents right, the delegations clear and flowing from that clarity around policies and procedures. As these documents fall into place in cascading order it becomes possible for other documents like employment contracts, funding documentation and so on, to also fall into line - and that line is one falling from and consistent with, the organisation's charitable purpose. Amongst those documents should be documents appointing the governors. Those documents could follow the ACNC template document.

By **dynamics** I mean the interaction of stakeholders. These divide into a number of areas. Perhaps the most important initial one is the relationships within the board itself. The dynamics between the board and the executive and the board and the membership (if there is one) is, though, similarly important. Dynamics do not just stop at the internals, though, the charity's relationship with its community including its beneficiaries, the donors, funders and even its regulator is important.

By discipline I mean the character, capacity and competence of the individuals involved in the charity. I use the word discipline because it takes discipline to develop one's *character* over time. It takes discipline to create the *capacity* to properly discharge governance functions. Most of the time it is the discipline to say no to the multitude of demands that are made upon us so that we have the time and energy to devote to the governance tasks before us. It takes discipline to develop the skills necessary to have the *competencies* required of a board member. It takes discipline to know and apply the duties. With good governors, good goals and good guidelines expressed in appropriate documents, dynamics and discipline, the stage is set for compliant action 24/7. So what is needed for such action?

## So what actually shapes action?

So now we come to achieving compliance 24/7. I turn in this section to what actually shapes human behaviour. I want to build on the significance of leadership, and in particular, authority. We cannot underestimate the power of authority and how people are affected for better or worse by the institutions of which they become a part. People do what they are told to do by authority figures. This lesson is illustrated most powerfully by the Migram Experiment. In that experiment ordinary people were told to inflict pain on others and they did so. Summarising the lesson of his study Stanley Migram said:

The ordinary person who shocked the victim did so out of a sense of obligation - a conception of his duties as a subject - and not from any peculiarly aggressive tendencies.

This is, perhaps, the most fundamental lesson of our study: ordinary people, simply doing their jobs, and without any particular hostility on their part, can become agents in a terrible destructive process. Moreover, even when the destructive effects of their work become patently clear, and they are asked to carry out actions incompatible with fundamental standards of morality, relatively few people have the resources needed to resist authority. A variety of inhibitions against disobeying authority come into play and successfully keep the person in his place.<sup>34</sup>

In Chapter 15 he explained the important influence of the institution.

Men do become angry; they do act hatefully and explode in rage against others. But not here. Something far more dangerous is revealed: the capacity for man to abandon his humanity, indeed, the inevitability that he does so, as he merges his unique personality into larger institutional structures.

This is a fatal flaw nature has designed into us, and which in the long run gives our species only a modest chance of survival. It is ironic that the virtues of loyalty, discipline, and self sacrifice that we value so highly in the individual are the very properties that create destructive organizational engines of war and bind men to malevolent systems of authority.

Each individual possesses a conscience which to a greater or lesser degree serves to restrain the unimpeded flow of impulses destructive to others. But when he merges his person into an organizational structure, a new creature replaces autonomous man, unhindered by the limitations of individual morality, freed of humane inhibition, mindful only of the sanctions of authority.

This authority that is set out here in the negative finds institutional expression in documents, dynamics and disciplined behaviours. This is quite troubling but it is a principle that applies in the reverse good governors setting good goals within good guidelines are powerful authority forces for good. What this points to is the need to ground the whole institution and its conduct in ethics. And deeper than that, in the context of a charity, because a charity exists for public benefit, it can and should be grounded in the identity of the institution itself. If this is done, every aspect of the entity does not just conform to legal compliance, it is transformative for good. The forces that operate for evil in the Migram Experiment operate for good in the charity. That this is so is underscored by research of Fred Kiel of KRW International summarised in the Harvard Business Review.<sup>35</sup> He looked at the impact of the character of leadership on performance.

Do highly principled leaders and their organizations perform especially well?

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<sup>34</sup> Stanley Migram (1974) Obedience to Authority <http://www.panarchy.org/milgram/obedience.html>

<sup>35</sup> Fred Kiel <https://www.youtube.com/watch?v=vqBPZR63vfA>

They do, according to a new study by KRW International, a Minneapolis-based leadership consultancy. The researchers found that CEOs whose employees gave them high marks for character had an average return on assets of 9.35% over a two-year period. That's nearly five times as much as what those with low character ratings had; their ROA averaged only 1.93%.<sup>36</sup>

Character can be developed. Keil wanted to change himself and he makes the point that it is mainly by character.

... character isn't just something you're born with. You can cultivate it and continue to hone it as you lead, act, and decide. The people who work for you will benefit from the tone you set. And now there's evidence that your company will too.<sup>37</sup>

Bringing this all together in an integrated process is the next step. That is though, the key to achieving compliance and beyond that, extraordinary performance 24/7.

## 24/7 involves an integrated process

I turn now to the practical. Achieving compliance 24/7 requires more than knowledge.

Over the last five or more years I have been working with charities to utilize the conformance obligations imposed by the law to drive improved performance by their organisations.

What I have identified is that there are five elements to successfully achieving compliance only one of which is achieving technical legal compliance.

Compliance, 24/7 compliance, has to derive ultimately out of a congruence. That congruence has to run from the narrative and context from which the charity derives its identity through its ethical frames into the way it discharges its legal obligations in governance decisions that find expression in compliant actions - 24/7. If this congruence can be achieved, though, the power is unleashed from the charity from the narrative to drive not just conformance but performance.

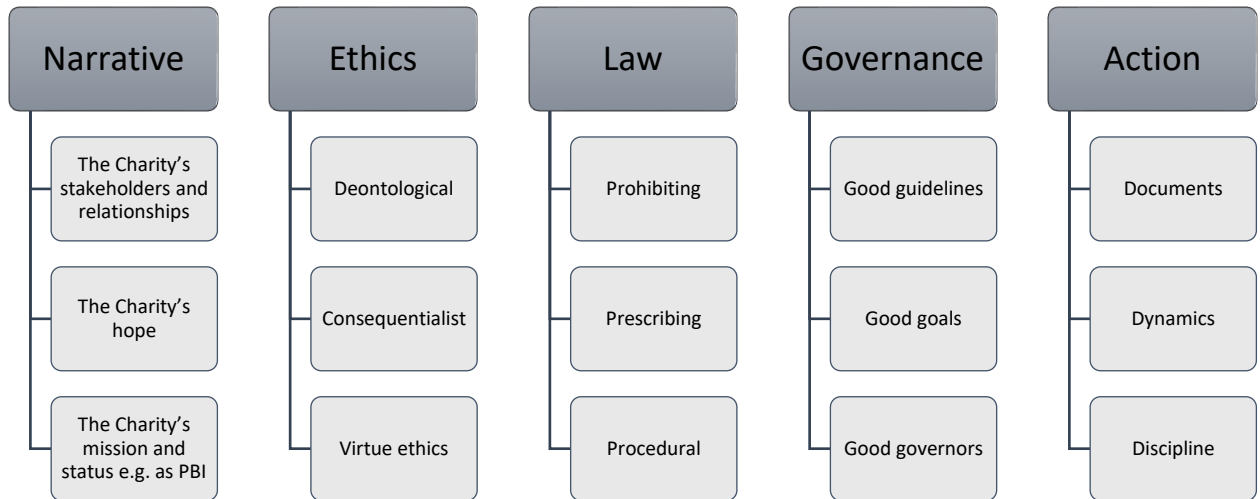
The diagram below summarises this.

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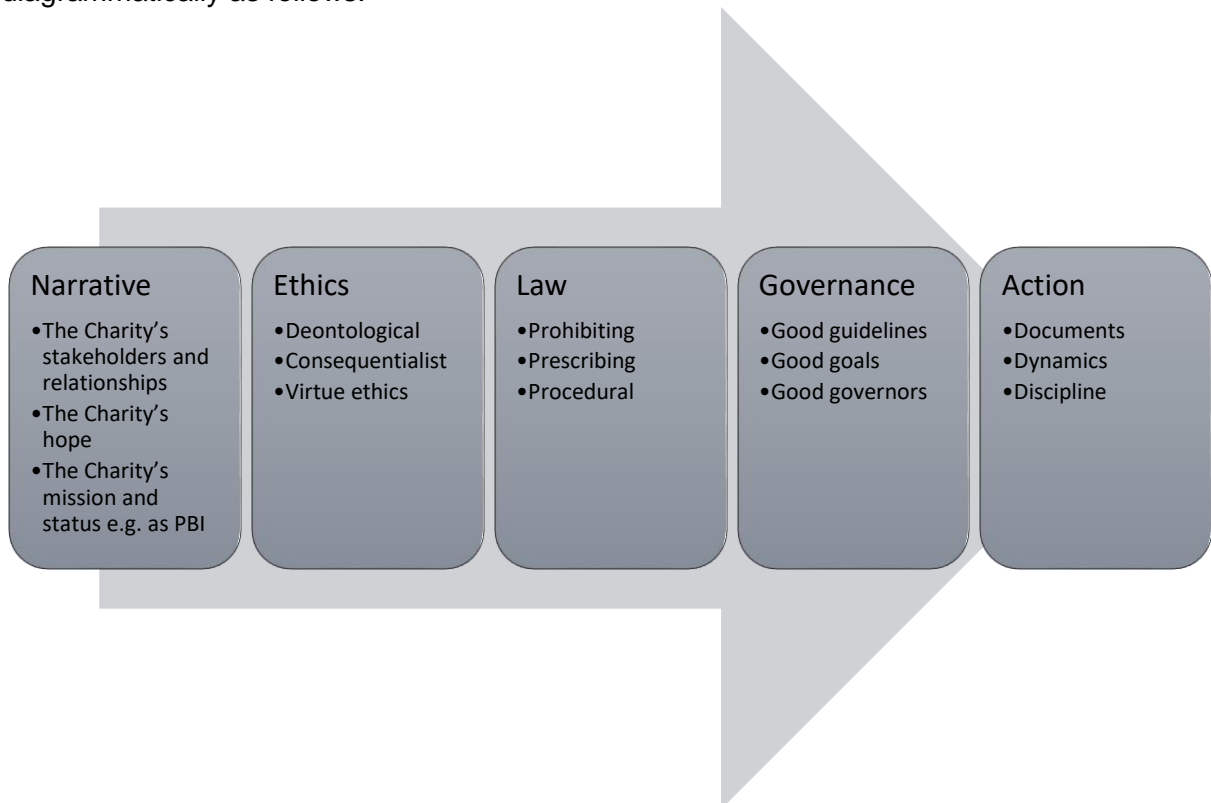
<sup>36</sup> 'MEASURING THE RETURN ON CHARACTER' 2015, *Harvard Business Review*, 93, 4, pp. 20.

<sup>37</sup> 'MEASURING THE RETURN ON CHARACTER' 2015, *Harvard Business Review*, 93, 4, pp. 21.





Bringing the elements into a process for working from identity to action can be summarised diagrammatically as follows:



This is a process that is best carried out across three or four days. I am limited here to just an overview.

## Concluding comments

Achieving compliance 24/7 requires an integrated approach from the identity of the NFP through ethics and laws to governance decisions and into action. Legal compliance lies at the centre of the process but is only one part of a complex matrix of factors. The discharge of fiduciary duties that lies at the core of this legal aspect can best be understood I suggest through the lens of ethics. Looked at through the lens of ethics I have suggested provides a key to solving some of the laws most difficult conundrums and also provides simple guidance to the NFP leader.