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Associations Forum National Conference

4th – 5th July 2016

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7A Good Governance & Bad Behaviour An examination of how Associations and Charities can manage risk

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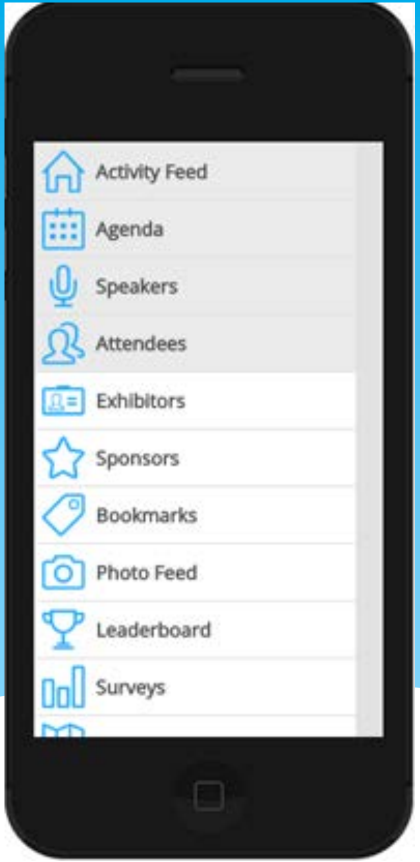
Associations Forum Conference App



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Good Governance & Bad Behaviour

Presented by Vera Visevic

Overview

- Common issues which arise out of the governing rules of organisations
- Effectively managing risk at board level
- Avoiding and dealing with disputes at a board and member level

A. Common Constitutional Issues

Where does good governance start?

Internal governance and procedures will be established in one of the following sources:

1. Statutory law (i.e. Model Rules and Replaceable Rules)
2. Common law
3. Constitution

Relevant statutes which apply to governing documents

Type of organisation	Relevant law
Public company limited by guarantee (PCLG)	*Corporations Act 2001* (Cth) - There are certain provisions named 'the Replaceable Rules' which apply to PCLGs and set out basic governing rules which form part of their constitutions. - PCLGs may replace these rules with some or all of their own if they wish.
Incorporated associations	Relevant State or Territory legislation, for example: - NSW has the *Associations Incorporation Act 2009.* - Victoria has the *Associations Incorporation Reform Act 2012.* - Queensland has *The Associations Incorporation Act 1981.* - Each State or Territory also has relevant Regulations.

Model Rules/Replaceable Rules

- Many State and Territory Acts or Regulations provide model rules, the function of which differs depending on jurisdiction.
- In Queensland, the model rules can alone govern an association if it wishes, and it does not need to have its own Constitution.
- The same is true of the Replaceable Rules for a company – they can be used instead of a Constitution.
- In NSW and Victoria, the model rules only apply if the Constitution is silent on a matter required to be covered in the Constitution by the Act.

What is a Constitution?

- A Constitution is also known as the rules or governing document of the organisation.
- It regulates the way an association or company operates.
- It is a legal contract between the association or company and its members that must be complied with.
- If the statutory law and common law are silent on an issue, you need to consult the Constitution.

What do Constitutions include?

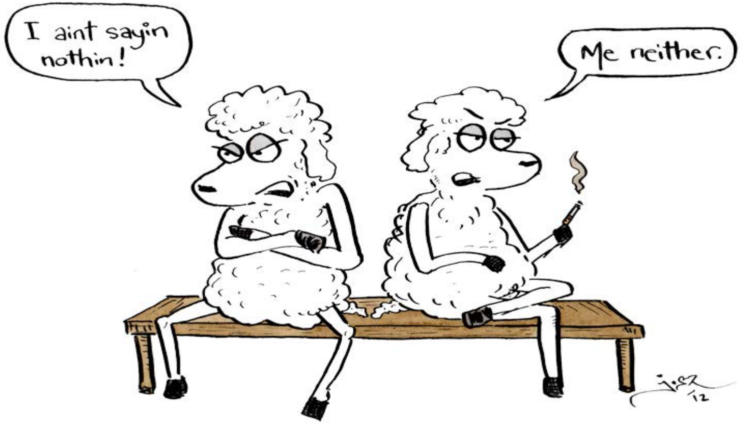
Constitutions should outline, at a minimum:

- the objects;
- the membership;
- internal procedures; and
- the board structure.

They should reflect the purpose of the organisation and how it is carried out.

The Constitutional Blanks

- However, associations and companies often encounter situations where their Constitution, the model rules/ Replaceable Rules and the legislation are silent.



The silence of the lambs.

Common issues

Which of the following issues are commonly drafted the most poorly in Constitutions:

1. Who can be a member;
2. Giving notice of meetings;
3. Irregularities (errors in procedure); or
4. Winding up clauses and distributions?

1. Membership

- Who is allowed to be a member?
  - Will membership be limited to natural persons?
  - Can bodies corporate be members?

1. Membership

- Constitutions should be clear as to who is eligible to be a member, and the process the board must follow to approve a member.
- This should include:
  - whether nominations from existing members are required;
  - if the board must give reasons for rejection;
  - what discretion the board has to reject members (it may be useful to allow the board unlimited discretion);
  - whether a majority vote is required for the board to approve a member; and
  - whether the power of membership approval can be delegated to, for example, a membership officer.

1. Membership

- It is important to have clearly defined criteria for membership and to continue to review these criteria.
- Your organisation may find it beneficial to its structure and finances to introduce different classes of membership.
- Why?
  - There may be potential members with significantly different interests relating to your organisation.
  - Classes of membership allow you to confer different rights, privileges and obligations on each class accordingly.

1. Membership

- A Constitution may make it unclear as to who is a member of the organisation.
- Being a member has legal consequences, and is not necessarily the people who are involved in the organisation.
- In some organisations, such as sporting clubs, only very few of the people who are actively involved in the organisation's activities are actually members in a legal sense.
- Failing to clearly define the requirements for being a member can create difficulties in defining voting rights at AGMs.

2. Notices of meetings

- Sending notices of meetings
  - In an environment where everything is electronic, it is vital to ensure that the Constitution is clear on how notices of meeting are to be sent. Are they able to be sent via email?
  - As notices are required to be sent a specified time before the meeting is to take place, the constitution should establish when a notice is deemed to be sent.
  - Often, notices of meetings are sent at the last minute. If the requirements surrounding notices are unclear, this can be the difference between a valid and invalid meeting.

2. Notice of meetings

- Withdrawal of notice
  - If a Constitution is silent on whether a notice of a meeting can be withdrawn or amended, the meeting as originally called will still need to be held.
  - This requires the first meeting to be held, at which the board explains that either the meeting is dissolved, or that there is to be another meeting to consider the amended resolution.
  - This can be an administrative nightmare, require legal advice, and cost money.

3. Irregularities - Case Study

- An organisation calls a Special General Meeting (**SGM**), at which an important special resolution to change the Constitution occurs.
- 21 days' notice is provided for the SGM, as required by both the Constitution and the law.
- Following the meeting, it is discovered that one member did not receive notice to the meeting, as the notice was sent to the incorrect address.
- That member now wants all business transacted at the meeting to be declared invalid.
- How can this be remedied?

3. Irregularities

- In some scenarios, the Constitution can specify that if particular irregularities are accidental, then this will not invalidate any business that is associated with the irregularity.
- A common clause deals with the exact situation in the case study, where there was an accidental omission to give notice to every single member entitled to receive it.

4. Winding Up Clauses and Distribution

- Even though it may seem far off, constitutions should be clear as to what is to happen to "surplus assets" upon winding up.
- Winding up clauses are particularly important if your association is seeking or enjoys certain tax exemptions.

4. Winding Up Clauses and Distribution

- Sometimes a charity is a deductible gift recipient (**DGR**), but its winding up clause does not meet the legal requirements for being a DGR.
- If this is the case, the Australian Taxation Office may strip the charity of its DGR status.
- A charity is allowed to make distributions to members that are also charitable and have similar objects. The winding up clause needs to specify whether this can occur.

B. Managing risk at a board level

Overview

1. **Board administration:**
   a. board papers and agenda;
   b. minutes of meetings; and
   c. board charters.
2. **Board structure and function:**
   a. board composition;
   b. quorum; and
   c. guests at board meetings.
3. **Risk management at a board level through the Constitution:**
   a. conflicts of interest;
   b. indemnity clauses;
   c. delegated authority; and
   d. split of power between board and members.

1.a. Board administration: Board papers and agendas

- Board papers are essentially information packages that assist the directors to make an informed decision on matters which are put before them. They are formal records of the information and advice upon which the board relied in making its decision.
- An agenda outlines the issues that will be discussed at the board meeting.

1.a. Board administration: Board papers and agendas

Important lessons from *ASIC v Hellicar and Others* [2012] (the James Hardie case)

- Directors must include items on the agenda that relate to their involvement in monitoring the company, that is, matters that need critical and detailed attention. This cannot be delegated.
- Directors must read all the board papers, including documents they are asked to approve, to make sure they understand the underlying facts about the agenda items.
- If directors do not understand anything in the agenda or board papers, they must speak up.
- Boards may be required to approve announcements or press releases that relate to matters that are of considerable importance to the organisation's future or matters of importance to stakeholders.

1.b. Board administration: Minutes of meetings

- Minutes of meetings provide a relatively complete picture of what information the board has based its decision on, as well as the reasons for which a particular decision was made.
- Minutes of meeting can be used as evidence in legal proceedings as to what happened in a board meeting.

1.b. Board administration: Minutes of meetings

The *James Hardie* case also provides important lessons in relation to minutes of meetings. These include:

- Directors should bear in mind the importance of minutes of meetings when they are involved in the preparation of, and reviewing, the minutes.
- Importantly, if minutes are prepared before a meeting, directors should ensure:
  - the content is prepared at the same time as the board papers; and
  - the minutes are amended after the meeting so they include substance, accurately recording the discussions and events at the meeting.
- Directors must read the draft minutes carefully, to ensure that they accurately record the discussions and events at the meeting, and raise any concerns, before approving the minutes. All directors need to do this and it is an important risk minimisation exercise.
- Directors should ensure that the minutes are entered into the minute book within one (1) month after the meeting, so they do not breach section 251A(1) of the *Corporations Act* and lose their special evidentiary status.

1.c. Board administration: Board charter

- A board charter is a written policy document that clearly defines the respective roles, responsibilities and authorities of the board of directors.
- It is an ancillary document to the Constitution which is intended to provide guidance on how the board is to operate.
- A board charter can be much more detailed than a Constitution and does not need the approval of members to be amended.

1.c. Board administration: Board charter

Board charters should touch upon:

- defining governance roles (e.g. roles of office bearers);
- key board functions (e.g. strategy, risk management);
- improving board processes (e.g. board meeting agendas); and
- board effectiveness (e.g. board evaluation).

2. Board structure and function – Case study

- Lily, a new director, is about to be appointed to the board of the Society for Cheese Preservation.
- She has performed her due diligence on the organisation and has discovered the following facts:
  - there are 15 directors on the board;
  - the Constitution includes terms for directors, but there are no maximum terms;
  - many of the directors dismiss the importance of meetings and there is rarely a quorum (but meetings proceed regardless);
  - there is an executive committee which consists of the President, CEO and Treasurer, who routinely make decisions in between board meetings; and
  - a former president is an ex-officio member of the board, but cannot vote.
- Should Lily join the board, or are there any issues she should be concerned about before joining? If so, what are they and how can they be solved?

2. Board structure and function – Case study

The importance of managing risk

- Directors are entrusted with power to make important decisions that can affect every aspect of the organisation.
- Key mechanisms to minimise risk at a board level include a well thought-out board structure, well thought-out time periods for directors and the use of co-opted directors.
- A Constitution should include criteria for who is to be a director.
- An organisation should consider a nominations committee, which considers the appointment of new directors.

2.a. Board structure and function: Board composition

Composition

- Appropriate composition is a delicate balance between ensuring there are adequate controls of who can be a director, and also ensuring the structure is not too convoluted.
- Consider how to improve the quality of directors, such as:
  - giving new directors an initial one year term;
  - using a nominations committee; and
  - inserting provisions to prevent rogue directors from returning in a different director role.

2.a. Board structure and function: Board composition

Composition

- It is important that your Constitution addresses not only how directors are appointed or elected, but also the composition of the board.
- Provisions regarding the composition of the board structure should be clear and logical.

2.a. Board structure and function: Board composition

Composition

- It is important that the structure of a board, while being comprehensive, is also not too “fancy”.
- Some board structures allow for too many directors, or include too many classes of directors, resulting in the positions being difficult to fill.

2.a. Board structure and function: Board composition

Co-opted directors

- You should consider whether you want to appoint co-opted or specially qualified directors.
- Boards are increasingly moving towards being skilled-based.
- Co-opted directors are appointed by the board to fill in the skills gaps.
- If there are no co-opted directors, then the entire board will most likely come from the membership base, and may not have the requisite skills.

2.a. Board structure and function: Board composition

Terms

- The Constitution should ensure that board members do not become entrenched, yet stay long enough to make a contribution and maintain corporate knowledge.
- Consider whether a new board should be elected each year, or if the board should be elected or appointed on a staggering basis (for example, where each director serves a three year term and one third are elected each year).
- If the terms of directors are to be staggered, this needs to be made very clear, and directors should have a clear idea as to when both their and other directors’ terms are to end.

2.a. Board structure and function: Board composition

Transition

- The transitions between being in different classes of directors can be poorly drafted in constitutions.
- There may be times where the board wishes to move a director from one class to another.
- If this is to occur, does the director need to first resign from his or her position, or can the director simply transition?
- Also, if you are to change your constitution or structure, how will the current directors' terms be treated?

2.b. Board structure and function: Quorum

Case study

- An organisation's constitution specified that the quorum for board meetings was 5 directors.
- Several directors resigned, leaving the board with only 4 directors.
- The board passed resolutions during this period, and needed to then obtain legal advice on whether these decisions were valid.
- How could this have been avoided?

2.b. Board structure and function: Quorum

- Under the common law, an inquorate board can only make decisions that are insubstantial in nature.
- A Constitution can remedy this by specifying whether a board can act if it falls below quorum due to resignations.
- The Constitution may specify that if the board drops below quorum, it can act for the purpose of adding replacement directors, or in emergencies, but for no other purpose.

2.c. Board structure and function: Guests at Board Meetings

- Sometimes, a board will want to invite non-directors to board meetings.
- This can be problematic if the duties and responsibilities of guests at the meetings are not clearly spelt out in the Constitution.
- For example, if the guests are participating in decision-making, and their decisions are being relied upon, then they may be found at law to be what is known as a "shadow director".
- Avoid having directors who are not permitted to vote.

3.a. Risk management at a board level through the Constitution: Conflicts of interest

- The Constitution should outline, if there is a conflict of interest, whether the conflicted director or committee member can:
  - be present while the matter is discussed;
  - vote on the matter;
  - be counted in determining whether a quorum is present;
  - sign any document regarding the matter; or
  - vote in respect of another matter arising out of the proposed contract.
- The Constitution should also outline how a matter is to be treated if a director or committee member is conflicted in a resolution and does not reveal the conflict, but it is later discovered.

3.b. Risk management at a board level through the Constitution: Indemnity clauses

- You should ensure that your indemnity clause adequately protects the liability of your directors in situations such as disciplining members.
- The indemnity clause should not be drafted too widely or narrowly.

3.c. Risk management at a board level through the Constitution: Delegated authority

- It may be convenient for the board to delegate tasks to committees to assist with certain aspects of the organisation's governance.
- This can be through the delegation of powers, or merely allowing the committee to make recommendations.
- Your Constitution should be clear on:
  - the procedure to establish committees;
  - how they are to be constituted;
  - a process for their routine/regular review to ensure they remain relevant;
  - the powers of the committees; and
  - how they are to operate.

3. d. Risk management at a board level through the Constitution: Split of power between board and members

- Members owe no fiduciary duty to the company, nor any of the other duties of a director or a committee member.
- If members are given a power that is normally held by the board, there is less regulation of their behaviour, as there is no duty to uphold.
- An organisation should be careful of giving powers to members for this reason.

C. Disputes at a board and member level

Common issues

Which issue is more relevant to your organisation:

1. Dispute resolution; or
2. Discipline (members and board members)?

1. Dispute resolution - Case study

- A peak body plans to hold conferences throughout the country. It tasks the various State bodies with organising the conferences in the State capitals.
- A conference held in Sydney makes no profit and the peak body accuses the NSW State body of not organising the conference correctly and that the NSW State body should cover the losses.
- The NSW State body claims that it was not provided with enough support or guidance from the peak body.
- How is this dispute to be resolved?

1. Dispute resolution

- Internal disputes are the disputes that occur between management, between the board and members and between members.
- A public company limited by guarantee is not required to have a dispute resolution clause in its Constitution, unless it is a charity and has a fundraising licence in NSW.
- The ACNC provides a template Constitution for public companies limited by guarantee, which includes a dispute resolution clause.
- The Model Rules for incorporated associations contain dispute resolution clauses.
- Every organisation should ensure that it has a dispute resolution clause, and it should be aware of its contents.
- Courts are reluctant to get involved in internal disputes.

1. Dispute resolution

- Commonly, mediation is prescribed in a Constitution as an initial stage of dispute resolution.
- If mediation is not prescribed, it is recommended the dispute resolution clause should include this.
- Mediation enables the disputing parties to communicate the details of their complaint in a collaborate environment, with the assistance of an impartial mediator.

2. Discipline

Case study:

A member has been acting in a manner contrary to the interests of the organisation.

How can you remove that member?

2.a. Discipline - Members

- While Constitutions usually outline how to admit members, they do not always outline how to remove members.
- Particular rules that may be included are:
  - Whether a majority vote of the board is sufficient to remove a board member;
  - What rights will the person being considered for removal have, such as written or oral submissions; and
  - Will the process need to occur in accordance with natural justice?
  - Is there a right of appeal?

2.a. Discipline - Members

- Some clauses regarding discipline are illegal, and are therefore void. For example, if a Constitution says that members can be financially penalised by the organisation, this is invalid.
- Some States' associations legislation outlines the requirements for disciplining members.
    - E.g. in NSW, the constitution must address the procedure for disciplining members, including an appeals process.
- The Replaceable Rules are not as helpful for this issue.

2.b. Discipline - Directors

- The removal of directors in companies is regulated by legislation.
- The Constitution should make clear whether removal for missing meetings is automatic, or requires a resolution of the Board.
- Beyond that, the Constitution has to be very clear about the situations in which a director has to vacate.
- Can directors be required to comply with pre-determined Key Performance Indicators?

2.b. Discipline - Directors

- The Corporations Act imposes requirements for the removal of a Director. However, for an incorporated association, the legislation does not usually specify if it is permissible and, if it is, the process that needs to be followed.
- The Constitution should ensure that these gaps are filled with a detailed process.
- In either a public company limited by guarantee or an incorporated association, the Constitution should specify whether, in the case of an appointed director, the appointor has the power to remove the director.

Questions?

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