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THIRD dimension

A practical legal perspective for charities and not-for-profits

MILLS OAKLEY LAWYERS

A Merger By Any Other Name Is Just As Sweet

BY Guy Williams, Lawyer

'Mergers' are becoming a commonly discussed topic in the not-for-profit sector (**NFP sector**), and with good reason - they have the potential for long-term benefits for all parties involved.

Our experience has shown, however, that it is common for not-for-profit organisations (**NFPs**) to feel apprehensive about the prospect of merging since:

- boards and working cultures must be responsive and cooperative towards a merger;
- a proposed merger could be resisted, poorly received or opposed due to the emotional investment of board members, staff, members, volunteers and funders; and
- a merger takes careful and considerable planning, time and money.

While the board and management of a NFP should always be alert to opportunities that will improve efficiency and sustainability, the very tight structural integration which is required between merging organisations is not always the best solution. An alternative is collaboration which, whilst much more informal and accessible, can still provide NFPs with tangible benefits if done correctly.

1. Benefits of collaboration

(a) Increasing impact

There are three main ways that collaboration might increase the impact of a NFP's activities:

- leveraging better people, systems, facilities and infrastructure from one project/organisation to improve the other;
- adopting processes from one project/organisation such as practices, standards and guidelines; or
- introducing strong projects to new communities/markets/industries.

The Southern Grampians & Glenelg Primary Care Partnership[1] found that knowledge sharing was a key benefit from their collaboration. Janette Lowe, Executive Officer of the partnership, commented that collaborations allow organisations to examine social issues in their entirety rather than being forced by their mandate to restrict their scope[2].

In the US, Big Brothers Big Sisters of America formed an alliance with Boys and Girls Clubs of America to align the mentoring programs of the former with the development programs of the latter to benefit the clients of both[3].

(b) Improving access to funding

Collaboration in the NFP sector has the purpose of increasing market power to improve access to funding. This can happen in one of two ways:

1. Improving the effectiveness of the funding functions: consolidation of the fundraising effort between organisations can increase the efficiency of how funds are raised by delivering more for the same amount of effort; or
2. Improving the effectiveness of advocacy and influence: collaboration between organisations with a common agenda increases impact. Furthermore, an increased presence will assist in marketing to private donors.

> **"Collaborations allow organisations to examine social issues in their entirety rather than being forced by their mandate to restrict their scope."**
>
> Janette Lowe
> Executive Officer of the Southern Grampians & Glenelg Primary Care Partnership

In 2014, eight of Australia's State-based spinal cord injury organisations created the Australian Spinal Injury Alliance in order to collaborate towards common priorities. Each of the organisations have preserved their independence, whilst leveraging the collective benefits of an organisation that represents the interests of people with spinal cord injuries, facilitates discussion and promotes co-ordination on a national level.

(c) Reducing capital requirements or costs

Resource constraint is a major driver for collaboration activity in the NFP sector. Collaborations can reduce costs by increasing the efficiency of resources by:

- rationalising shared services and back-office functions: integrating back-office functions (e.g. IT, finance and payroll) for multiple organisations will save costs, allowing more resources to be focused on project delivery; and
- increasing asset utilisation: for example Social Ventures Australia, Career Trackers and AIME all share an office in Melbourne, defraying costs and using heating, lighting and fixed office equipment more efficiently.

2. Collaboration must be done correctly

Delivering more to members without the hassle of a merger sounds like a win-win. However, before jumping into bed with another organisation, you must consider the following in order to have a successful collaboration.

1 A collaboration between Glenelg Shire Council, Southern Grampian Shire Council and local NFPs.

2 The Office for the Community Sector, Department of Planning and Community Development, Community collaboration: The changing context of local government and community sector partnerships (1 July 2013), <http://www.dhs.vic.gov.au/__data/assets/word_doc/0005/832172/Community-collaboration-The-changing-context-of-local-government-and-community-sector-partnerships-1-July-2013.doc>

3 Big Brothers Big Sisters, Two National Youth Charities Strike Partnerships to Share Resources (15 October 2009), <http://www.bbbs.org/site/c.9iILI3NGKhK6F/b.6065577/apps/s/content.asp?ct=8211673>

(a) The collaboration must be member-driven

The following comment from Paul Murnane, the former Chair of MS Society of NSW, is something that needs to be at the forefront of any decision to collaborate. Although increased funding had been an important outcome of the merger between the Victorian MS Society and MS Society of NSW, Mr Murnane stated that "we wouldn't have gone ahead with the merger if it didn't benefit the client".

Whilst there may be several reasons to collaborate, a collaboration should only proceed if it is being driven primarily by the pursuit of improving service to members or clients.

(b) Support must come from the top...

Some of the characteristics that give the NFP sector strength (commitment, passion, and single-mindedness) can militate against effective collaboration. Boards must, therefore, take it upon themselves to consider collaborations as a valid strategic alternative. Board members are obliged to always be looking outside the organisation for opportunities to pursue the mission or purpose of their organisation.

(c) ...and the bottom

A new collaboration will almost certainly require some change, and keeping all employees informed of any change is imperative. Openness by the board and management is extremely important and organisations need to have frank conversations at the start of the project to ensure effective communication with stakeholders. In our experience, granting people sufficient time to understand the reason for the change and inviting them to be a part of it is a simple, yet effective method of earning employee support. Without their support, if not their enthusiasm, the collaboration will not succeed.

(d) Agree to disagree

Deal breakers should be identified at the earliest possible opportunity and shared with the potential partner. In our experience, we have found that 'difficult' questions do not melt away. They get more difficult the further down the track the discussions progress. This leads to the final point of...

(e) Formalising the collaboration

The rationale for collaboration must be clear, agreed by both parties and documented. Clarity about the planned outcomes of the collaboration and tracking of progress is critical. It is prudent for any formal contract to be preceded by a memorandum of understanding (**MOU**) which sets out the broad commercial terms. The MOU is essentially an agreement to agree, and will establish a framework and express the common goals of the parties. This can be followed by a formal contract which will be legally binding and provide assurance before significant further resources are applied towards the collaboration.

Checklist for Mergers

BY Clementine Baker, Lawyer

We've created this comprehensive checklist to help you prepare for a merger. It contains all the factors that you must consider, including the concept phase, exploration, due diligence examination and a preliminary integration plan.

A. Concept Phase		
Considering Merger		
1.	Have we properly considered what our purpose is as a not-for-profit (**NFP**)?	
2.	Is our proposed partner compatible in terms of its objects, strategic vision, culture, values, governance arrangements, organisational structures and funding base?	
3.	Have we considered what this company/association can contribute to our company/association? • research and development • members/beneficiaries/accounts • service range • market segment (geography, industry, price point, etc.) • specialised technology • human capital • revenue stream • financial assets • distribution channel • strength to lobby Government	
4.	Have we considered the options for obtaining the capabilities this company/association has? • merger/acquisition • joint venture • joint marketing/distribution agreement • strategic alliance agreement • licensing • commission/royalty agreement • consulting services • patent/technology • internal development	
5.	Is a merger in the best interests of our organisation and its beneficiaries? Will a merger enable us to achieve cost savings as well as improve the quality and/or quantity of service we offer?	
6.	Have we approached our stakeholders and beneficiaries for their views? If not, how and when are we going to?	
7.	What will be the risks and benefits for our organisation as a consequence of a formal merger? Have we considered the wider impacts on our organisation?	
8.	Are there any other forms of collaborative working we could explore that might achieve the same benefits?	
9.	Have we estimated the full cost of merging? This should include issues such as staff time, rebranding, professional fees, relocation and unanticipated costs.	

Considering Merger (continued)		
10.	Does our governing document or the law require the consent of the members in order to merge?	
11.	Are we carrying out a due diligence exercise? Can we do it in-house or do we need professional advice?	
B. Exploration		
Financial considerations		
12.	Have we considered the financial strength the other company/association? • assets • liabilities • revenue streams • strength of balance sheet	
13.	Have we checked their financial projections for the next 1-3 years?	
Culture considerations		
14.	Have we considered what is the prevailing culture of the other company/association? • bureaucratic • autocratic • entrepreneurial • egalitarian • high performing • market drive/technology driven	
15.	Would there be any potential cultural conflicts during integration?	
Legal considerations		
16.	Do we have the relevant legal powers to achieve our plan, or will we need help from a Government regulator?	
17.	Have we decided on a legal structure for the merged organisations?	
18.	Are we taking the appropriate professional advice and in what areas?	
19.	Are there any employment issues we need to consider? These could include issues such as superannuation, liabilities and compliance with employment law.	
20.	Have we considered the impact on any tax endorsements or other grants that we may have?	
21.	Are there restrictions on our organisation's sources of income? These could include special trusts, restricted funds, bequests or permanent endowments.	

C. Due Diligence Examination		
Financial Records		
22.	Have we conducted a more detailed examination of financial records, including an examination of the following: • patterns of maintenance and capital expenditures • patterns of marketing, sales, general and administrative expenses • unexposed liabilities • valuation methods for assets • determination of goodwill	
23.	Executive compensation	
Legal Exposure		
24.	Have we checked the following: • pending, probable or possible litigation • trademark/patent protection/violation • environmental exposure (real estate, compliance record) • safety and health practices and exposure • potential actions by employees • tax exposure	
Visual/Onsite Inspections		
25.	Have we conducted a detail examination of any contracts (terms, length, termination provisions, etc.)?	
Services		
26.	Have we conducted a detailed examination of the current services provided?	
27.	Have we considered their future service plans: • extension of current service line (enhancements)? • new service line?	
28.	Have we considered what resources have been allocated to future service/product development: • capital (equipment, buildings, or acquisitions) • personnel (headcount) • technology	
Human Resources Administration		
29.	Have we examined their compensation philosophy? How do their pay structures compare to ours? Will there be internal equity issues that we will have to address?	
30.	Have we considered how their benefit plans compare to ours? • education reimbursement • vacation/holidays • leave/time off policies • superannuation	

Human Resources Administration (continued)		
31.	Will we need to maintain separate benefits plans or can they be integrated with ours?	
32.	Is this company/association in compliance with major State and Federal regulations? This includes wage and labour standards.	
Workforce Competency		
33.	Have we examined the technical competence of the workforce?	
34.	Have we examined the areas of technical competence and technical weakness?	
35.	Have we examined the educational level of the workforce? Are there concentrations of well educated or poorly educated?	
36.	Have we considered the managerial competence level of this organisation? • planning/budgeting • leadership • project management • financial stewardship	
37.	Have we considered who the key technical, managerial and executive people are? Why are they considered key? What would happen if one or more of them left?	
Culture		
38.	Have we considered decision-making processes in the company/association? • what is the predominant style of making decisions? • who makes what decisions? With what input from whom? • what is the risk taking quotient? • how are failures/mistakes dealt with?	
39.	Are there cross-functional structures (steering committees, project teams, temporary teams, etc.)? How well do they work?	
40.	Have we considered their reward structure? • what do people get formally rewarded for? • on what basis do people get promoted or otherwise recognised? • what is most important to this company/association?	
41.	Have we considered the general norms of this company/association? • how are mediocre/poor performers dealt with? • to what degree is conflict encouraged or tolerated? • what are the typical responses to conflict? • how well are deadlines set and met? • how detailed is project planning? • how is input from various parties obtained and used? • what are the general modes of communications (written, verbal, phone, etc.)? • how are various stakeholders dealt with (members, volunteers, employees, etc.)?	
42.	Have we considered the general values of this company/association? E.g. quick response/flexibility, creativity, etc.	

D. Preliminary Integration Plan		
Preliminary Plan		
43.	Have we considered what areas of this company/association are unique and should be maintained? What are the core competencies we are trying to access? What areas/competencies of this company/association are redundant with ours?	
44.	What is the appropriate structure for this relationship? • merger/acquisition • joint venture • joint marketing/distribution agreement • strategic alliance agreement • exclusive partnering agreement • licensing • commission/royalty agreement • consulting services • patent/technology option • internal development	
45.	Have we considered the costs associated with the different options: • severance costs • relocation expenses • licensing fees • commissions/royalties	
Planning and Communicating		
46.	Have we identified an individual to manage the overall process?	
47.	Do we have a project plan with milestones in place to manage the process?	
48.	Have we established a project board, committee or group to oversee the project and to link into the respective governing bodies?	
49.	What interim governance arrangements should we put in place during the merger process?	
50.	Have we conducted a stakeholder analysis and established a communications plan that covers all existing and new stakeholders and audiences? This should cover communicating the merger to existing funders and staff.	
51.	Have we identified the risks associated with merging, such as reputational or operational risks, and put systems in place to mitigate those risks?	
52.	Have we identified ways to monitor the success of the merger and how it will be evaluated?	
Information Systems		
53.	What is the basic structure of the information system? How compatible is it with ours?	
54.	What are the basic data models used? How compatible are they with ours?	
55.	What metrics do they use and how are they tracked? How compatible are they with ours?	
56.	What information systems/linkages will need to be established between the two companies?	

Lawyers, Secrets and You

Legal Professional Privilege is a fundamental touchstone of Australia's legal system.

Privilege entitles a party to withhold documents and/or deny access to them on the basis that the documents contain confidential legal communications between a lawyer and client. It is a valuable protection.

Privilege exists and arises at both common law and in statue pursuant to the Evidence Act 1995 (NSW) (**Act**). Privilege at common law is known as "legal professional privilege" (**LPP**) and as "client legal privilege" (**CLP**) pursuant to the Act. The common law of privilege is now largely absorbed by and reflected in the Act, however the concept of CLP is not identical to common law LPP.

Privilege extends to all types of communications which includes records of oral communications and hard copy or electronic communications. This means that privilege extends to cover both the content and records of face-to-face discussions, letters, emails, faxes, photographs, taped telephone calls, electronic diary entries and voicemails. It also includes evidence of such communications, for example, files notes of phone calls or discussions.

In order for a communication to be privileged, the following elements must be satisfied:

- the communication must be confidential; and
- the communication must have been created for the dominant purpose of legal advice or providing legal services in respect of anticipated or existing litigation; and
- the communication must be with a lawyer.

Confidentiality is satisfied if at the time of making/preparing the communication, there was "an express or implied obligation not to disclose the contents" of the communication irrespective of whether that obligation arose at law. Once a communication ceases to be confidential it is no longer privileged, however, just because a document is confidential does not necessarily mean it is also privileged.

For the communication to be privileged it must be for the dominant purpose of providing advice or giving instructions. The dominant purpose test will be a question of fact in each case. Communications between a client and lawyer (or a communication/document prepared by the same or a third party) must have been made for the dominant purpose of the lawyer providing the client with legal advice. In respect of "legal advice", the advice must not be confined to telling the client the law, but it must include advice as to what should prudently and sensibly be done in the relevant legal context.

In order for advice to be "legal advice", a lawyer must have conveyed it acting in their role as a lawyer. Communication with a lawyer can include communication with an in-house lawyer, however, the in-house lawyer must be sufficiently independent of the employer such that the in-house lawyer's personal loyalties, duties or interests do not influence the advice given.

Where a communication has "lost privilege", a party may only see that particular communication that has "lost the privilege", however, in the case where privilege is waived, this may extend beyond the particular communication.

Privilege can only be waived by the client. However lawyers can, in error, waive their client's privilege. Waiver is an intentional act done with knowledge whereby a person abandons the privilege by acting in a manner inconsistent with it.

Waiver can occur:

1. expressly;
2. by agreement;
3. when the communication ceases to be confidential (for example, if the privileged communications are provided to another party, reading out a privileged communication in open court or when the communication is disclosed to a third party without imposing an obligation to maintain confidence);
4. by conduct;
5. by accidental disclosure in some circumstances.

Importantly, disclosure of the gist or conclusion of legal advice will amount to waiver of the whole communication and possibly related communications.

Tips to maintain privilege

1. Protect confidentiality: avoid disseminating legal advice or summaries of legal advice widely within your organisation. Forwarding emails that contain legal advice can result in the waiver of privilege. Further, avoid lengthy email chains.
2. Do not disclose the substance, gist or conclusion of legal advice.
3. Educate staff in relation to privilege and potential risks of document creation and dissemination.
4. If the information is legal advice or a communication to be sent to your lawyer, mark the communication as "Privileged and confidential for the purpose of legal advice".
5. Ascertain the purpose of the communication and why the communication is being created. If the communication is to contain both legal advice and non-legal advice, separate the document so the legal advice stands as an independent document from the non-legal advice.
6. Take care when creating reports, internal minutes and file notes. Avoid referring to legal advice in such documents.
7. If you are in-house counsel for your organisation and you are giving legal advice, ensure that you are acting as a lawyer, that is, ensure you are bringing an independent mind to the legal issue. Also, ensure you maintain a current practising certificate.
8. Have a document management policy which deals with how privileged communications are managed and stored.

New Rules for Income Tax Exempt NFPs

Summary of TR 2015/1

BY Isabelle Whelan, Lawyer

1. Overview

Division 50 of the *Income Tax Assessment Act 1997* (**ITAA 1997**) exempts from income tax the total ordinary and statutory income of an entity that is covered by one of the various items in the tables listed in the Division. Many of the items in the tables require that certain special conditions be satisfied before the income of an entity can be exempt from income tax. These special conditions vary depending on the nature of the entity.

This tax ruling provides guidance on how the law is interpreted and applied regarding two of the special conditions that certain not-for-profit and other organisations must meet to be exempt from income tax. These requirements were introduced in the *Tax Laws (Measures No. 2) Act 2013*, which require a not-for-profit organisation:

a. to comply with all the substantive requirements in its governing rules ('the governing rules condition'); and

b. to apply its income and assets solely for the purpose for which the entity is established ('the income and assets condition').

1.1. Date of Effect of these Special Conditions

These two additional special conditions apply to an entity from the entity's income year that commences on or after 1 July 2013.

1.2. Date of Effect of this Tax Ruling

The date of effect for the new tax ruling is 25 February 2015, but applies to income years prior to the current year.

2. Governing Rules Condition

The governing rules of an entity are those rules that authorise the policy, actions and affairs of the entity. That is, governing rules of an entity consist of the rules that direct:

a. what the entity is required and permitted to do; and

b. what those, who control the entity, are required and permitted to do in respect of the entity.

An entity may have governing rules from more than one source. However, the written documents under which an entity was formed will usually be the main source of its governing rules. An entity must identify all of its governing rules in order to then consider what the 'substantive' requirements are in those rules. Some examples of 'substantive' requirements contrasted with 'procedural' requirements are as follows:

Substantive requirements	Procedural requirements
• objects/purposes; • non-profit status; • powers and duties of directors/officers; • audit and accounts; and • winding up.	• membership; • meetings; and • votes of members.

Please, therefore, ensure that your constitution is always up to date. Otherwise this will cause you problems if:

a. your organisation is required to comply with an out of date constitution in order to remain income tax exempt; or

b. your organisation decides not to comply with your outdated constitution in order to comply with other laws, and this results in your organisation no longer being income tax exempt.

3. Income and Assets Condition

3.1. Condition

The income and assets condition requires an entity to 'apply its income and assets solely for the purpose for which the entity is established'.

Two questions must be considered to determine whether an entity satisfies the income and assets condition:

a. what is the 'purpose for which the entity is established'; and

b. has the entity applied its income and assets solely for the purpose for which the entity is established?

3.2. Purpose for which the entity is established

The 'purpose for which the entity is established' is determined by a consideration of all of the features of the entity. The main factors to be considered are:

a. the objects in the entity's constituent documents;

b. the activities of the entity after its formation, up to the time at which the income and assets condition is applied;

c. policies and plans;

d. administration;

e. finances;

f. history;

g. control; and

h. any legislation governing the operation of the entity.

3.3. Incidental or Ancillary Purposes

The purpose for which the entity is established can include an incidental or ancillary purpose. A purpose is incidental or ancillary to the purpose for which the entity is established if it tends to assist, or naturally goes with, the achievement of that purpose. It does not mean a purpose that is minor in quantitative terms.

3.4. Accumulation

The income of an entity may still be 'applied' for the purpose for which the entity is established if some of the entity's income (whether it be gross income or net income) is accumulated, provided the accumulation is consistent with the purpose for which the entity is established. An entity may use some of its income to acquire assets which, in future, will produce income for its purpose or purposes, and may accumulate some of its income for later distribution.

To satisfy the income and assets condition, an entity that accumulates most of its income over a number of years will need to show on a year by year basis that the accumulation is consistent with the purpose for which the entity is established.

Please note that excessive or indefinite accumulation is not permissible under the income and assets condition. An entity's entitlement to income tax exemption is a year by year assessment.

The relevant factors to be considered include whether the entity has identified:

a. when its income is to be applied to its purpose;

b. how its income is to be applied to its purpose; and

c. if accumulation is to continue for an extended period, the reasons for this.

3.5. Meaning of 'Solely'

The income and assets condition requires an entity to apply its income and assets 'solely' for the purpose for which the entity is established. This means that the entity must exclusively or only apply its income and assets for that purpose.

A strict standard of compliance is required under the 'solely' test. Nevertheless, the Commissioner accepts that misapplications of an entity's income and assets of an insignificant nature will not result in a breach of the condition. Relevant considerations include the amount of the misapplication and how often the misapplication occurs. The income and assets condition will still be satisfied where:

a. the misapplication or misapplications are immaterial in amount; and

b. there is a one-off misapplication or occasional, unrelated misapplications of part of the income or assets of an entity for a purpose other than the purpose for which the entity is established.

4. Relationship between the Governing Rules Condition and the Income and Assets Condition

The governing rules condition and the income and assets condition are independent special conditions that must be satisfied by an entity (in addition to other special conditions for some entities) in order for its ordinary and statutory income to be exempt from income tax under Division 50.

While an entity is in breach of either or both of the special conditions, its ordinary and statutory income will not be exempt from income tax.

5. Corrective Action

In some circumstances, an entity may take subsequent action to correct:

a. a breach of a substantive requirement in an entity's governing rules; or

b. the application of part of its income or assets to a purpose other than the purpose for which it is established ('misapplication').

For the purpose of the Commissioner's administration of the governing rules condition and the income and assets condition, this is referred to as 'corrective action' having taken place in relation to the relevant breach or misapplication.

Corrective action has the overall effect of putting the entity back to the same position it was before the breach or misapplication occurred. Nevertheless, in such circumstances, a breach or misapplication is still taken to have occurred, although the effects of the breach have been reversed.

While an entity is in breach of either or both of the special conditions, its ordinary and statutory income will not be exempt from income tax.

Top Four Legal Issues Impacting NFPs and Charities

BY Vera Visevic, Partner

In our experience, the four most common legal issues impacting NFPs and charities are: legal duties, liability, indemnities and insurance, common constitutional problems, and intellectual property issues. Below is a summary of the law on these issues.

1. LEGAL DUTIES

Type of Duty	Description of the Legal Duty
NFPs	
Fiduciary duties	The duty of good faith (section 181(1) of the *Corporations Act*) has a number of components and requires directors to: • act honestly (and not misappropriate the company's assets); • exercise their powers in the interests of the company (and avoid misusing their powers); and • avoid conflicts of interests.

Duty of care, skill and diligence	• The common law, equity and statute impose a duty of care, skill and diligence on directors.
	• Section 180(1) of the *Corporations Act* provides that directors must exercise their powers and discharge their duties with the degree of care and diligence that a reasonable person would exercise if they:
	  • were a director of a company in the company's circumstances;
	  • occupied the office held by and had the same responsibilities within the company as that director.
	• Under this statutory duty of care, an objective standard is imposed.

Defences	• Business judgment rule (section 180(2) of the *Corporations Act*). • Ought fairly to be excused (section 1318 of the *Corporations Act*).
Improper use of position or information	Sections 182 and 183 of the *Corporations Act* 2001 provide that a director, secretary or employee must not improperly use: • their position; or • information (obtained because they are or have been a director etc. of a corporation); to: • gain an advantage for themselves or someone else; or • cause detriment to the corporation.

Type of Duty (continued)	**Description of the Legal Duty** (continued)
Improper use of position or information	Penalty - Under the *Corporations Act* • As with a breach of sections 180 and 181, contravention of sections 182 and 183 may result in a pecuniary penalty of up to $200,000.
Insolvent trading	A director is under a duty to prevent insolvent trading under section 588G of the *Corporations Act.* • *(e.g. National Safety Case).*
Duty to disclose	• Under section 191 of the *Corporations Act*, a director or an officer of the company must disclose a material personal interest in a matter that relates to the affairs of the company and must give the other directors notice of the interest under section 191(2) applies. • Disclosure must be made to a meeting of the board as soon as practicable after the director becomes aware of the interest.
NFPs and Charities	

WH&S	• You will all be aware of the increasingly onerous but proper obligations on directors and managers of companies to ensure the safety of workers and other people in the workplace, which is itself a very broad term.
	• The scheme of the legislation is:
	  • intended to ensure that the board and upper levels of management take workplace safety seriously; and
	  • does this by imposing non-delegable duties on them in addition to severe criminal penalties.
	• The fines cannot be paid by the company and in many cases the mere fact that an injury has occurred is evidence of a failure to provide a safe workplace.

WH&S exemption for non-paid directors	• Section 34 of the *WH&S Act* creates an exception for volunteer directors or officers so that volunteers cannot be prosecuted for a failure to comply with a health and safety duty (except a duty under section 28 or 29). • This may impact on whether you pay your directors.
Charities	

Governance Standard 5	• The following duties are switched off by section 111L of the *Corporations Act* and replaced with the Governance Standards:
	  • The duty of care and diligence – section 180;
	  • The duty to act in good faith – section 181;
	  • The duty not to misuse position – section 182; and
	  • The duty not to misuse information - section 183.

2. LIABILITY, INDEMNITIES AND INSURANCE

Type of Liability	Description of Legal Liability
NFPs and Charities	

Personal civil liability	• Personal civil liability means that the director or committee member has a legal responsibility to another person or persons. Failure to meet that responsibility which results in an injury to a person may mean that the director or committee member can be sued by that injured person.
	• Personal liability refers to situations where a director:
	  • has to use personal funds to meet the organisation's obligations;
	  • has to make good losses caused to the organisation because of his or her actions;
	  • has to repay the organisation any personal profit from an unauthorised contract or transaction; or
	  • is held liable in law for offences caused by or on behalf of the organisation.

Civil liability exemption	• The fact that directors and officers may be acting in a voluntary capacity and not being paid for their services makes no difference to their legal duties and obligations. • However, volunteer directors and officers will be exempted from personal civil liability for their actions while carrying out their volunteer community work. This protection comes from the various State and Commonwealth civil liability or civil wrongs laws.
Tax	• The *Tax Laws Amendment (2012 Measures No 2) Act* 2012 creates a greater obligation upon directors to ensure companies remit the pay-as-you-go (**PAYG**) withheld amounts, as well as superannuation guarantee charges within the statutory timeframe. • If the PAYG withheld amount is unreported and unpaid three months after the due date, the ATO can issue a director a penalty notice. • The director is personally liable for the full amount of the debt.

Superannuation	• Each quarter, a superannuation guarantee statement is to be lodged with the ATO and a superannuation guarantee charge will apply to an employer who fails to make the minimum superannuation contribution by the due date for the quarter.
	• If the employer fails to make the payment, personal liability will apply from the lodgement day.
	<u>Defences</u>
	• A director is not liable for a director penalty if the director can establish that:
	  • Because of illness or for some other good reason, the director was not involved in the management of the company and it was reasonable for the director not to be involved; or
	  • he/she took all reasonable steps to ensure the directors caused one of these three things to happen (or no such steps were available):
	  • the company to meet its obligations to pay;
	  • an administrator of the company to be appointed; or

Type of Liability (continued)	**Description of Legal Liability** (continued)
Superannuation (continued)	• the company to begin to be wound up; or • the penalty resulted from the company treating the Superannuation *Guarantee Administration Act 1992* (**SGAA**) as applying to a matter or identical to matters in a particular way that was reasonably arguable, if the company took reasonable care in connection with applying the SGAA to the matter or matters.

Type of Insurance/Indemnity	**Description of Insurance/Indemnity**
NFPs and Charities	

Deeds of Access, Indemnity and Insurance (Indemnity deeds)	• A deed of indemnity sets out the basis for the company to indemnify the director for personal liabilities and associated legal costs which result from their role as a director.
	• Deeds of indemnity also commonly deal with matters such as access to documents and insurance.
	• A company is prohibited from indemnifying a director for:
	  • a liability owed to the company, for example for a breach of duty owed to the company;
	  • a liability for certain specified penalty orders and compensation orders;
	  • liabilities arising out of fraudulent, dishonest or criminal behaviour, or conduct involving lack of good faith; and
	  • liabilities for legal costs to the above matters, where the director does not successfully defend the claim.

3. COMMON CONSTITUTIONAL PROBLEMS

Areas of Interest	Common Constitutional Questions and Problems
NFPs and Charities	

1. Objects	Question: How do I draft the objects clause of the constitution?
	Answer:
	• The objects clause of the constitution reflects the following:
	  • the purpose of the organisation;
	  • the future direction of the organisation; and
	  • the current activities of the organisation.
	• The objects clause is an important clause as it should accurately reflect your tax status.
	• Your objects clause should also be consistent with the content of your website.

2. PBI Status	Question: How do I ensure our entity's PBI status can be retained? **Answer:** • Check the activities the entity is undertaking – to maintain PBI endorsement, the ACNC must be satisfied that the vast majority of an entity's funding and resources are directed towards assisting needs that require benevolent relief. • Check the objects clause in the constitution. • Check the winding up/DGR revocation clause in the constitution.

3. Removal of Director	Question: How can you remove a Director from the board of a company?
	Answer:
	• Section 203D of the *Corporations Act* provides that a public company may by ordinary resolution remove a director before their period of office ends. This is a statutory right, conferred upon the company acting in general meeting. It applies despite anything in the company's constitution or any agreement between the company and the Director.
	• Procedure to remove a Company Director:
	  • Notice of intention – the members have to issue the company with notice of intention to move the resolution to remove the Director. The company must be given at least two (2) months notice before the meeting is held. This timeframe can be shortened, as explained below.
	  • Notice requirements – following receipt of the notice by the company, the company has to convene the meeting. The company can hold the meeting in less than two (2) months, so long as the notice for the meeting is issued after the company receives the notice from the members.
	  • Do you need a reason to remove a Director? – Generally there is no requirement to provide reasons to remove a Director of a public company under section 203D of the Act, as a Director's position is at the behest of the members.
	  • Director's rights – the Director is then permitted to:
	  • put their case to the members by speaking to the motion at the meeting; and

Areas of Interest (continued)	**Common Constitutional Questions and Problems** (continued)
3. Removal of Director (continued)	• give the company a written statement, stating their case, for circulation to the members. • Following the removal of the Director – the vacancy resulting from the removal of a Director by resolution in the fashion set out above, if not filled at the meeting (the members can appoint someone else to fill the vacancy by ordinary resolution), may be filled as a casual vacancy if this is permitted by the company's Constitution. • Procedural Irregularities – generally, an irregularity in the procedure set out above does not invalidate the removal of the Director, unless the Court is of the opinion that the irregularity causes 'substantial injustice' that cannot be remedied and declares the procedure to be invalid. • Consequences of Contravention of section 203D – breach of section 203D is an offence punishable by a fine of five penalty units, which is equivalent to $550. An offence based on section 203D is an offence of strict liability. This means that there is no defence to this offence.
4. Proxies at Board Meetings	Question: Are proxies allowed at board meetings? **Answer:** No.
5. Professional Bodies - Applications for Membership	Question: Can professional bodies reject applications for membership and not provide reasons? **Answer:** • No. It is essential that individual practitioners are fully qualified and accredited to enter into a profession and undertake their services with the level of skill and knowledge necessary to perform their duties to a high standard. Therefore, it is an important function of professional associations that they limit membership to persons who have fulfilled these prerequisites as this protects not only the interests of the profession but also consumers more generally. • However, while professional associations may impose minimum membership requirements, they should ensure that they are reasonable and not so onerous as to create an unnecessary barrier to entry into that profession, thereby limiting competition within the market for those services. • Professional association entry requirements should be clear and transparent and applied in a consistent and equitable manner to all potential members, with an appeal process available for those who are denied entry. The reasons for the imposition of these rules should be able to be substantiated by the association, and for the genuine purpose of maintaining the quality of services provided.

4. INTELLECTUAL PROPERTY ISSUES

Type of Intellectual Property Right	Description of Intellectual Property Rights
NFPs and Charities	
Trademark	**Registered Trade Mark** • A trade mark is a sign used to distinguish the goods and services of one trader from those of another. • A trade mark is a right that is granted for a letter, number, word, phrase, sound, smell, shape, logo, picture and/or aspect of packaging. • A registered trade mark is legally enforceable and gives you exclusive rights to commercially use, licence or sell it for the goods and services that it is registered under. • If you register a business, company or domain name, you do not automatically have the right to use that name as a trade mark. • To protect your business name from being used by someone else, you can register it as a trade mark. • The registration period initially lasts for 10 years and can be continued indefinitely providing that you pay renewal fees. The trade mark is protected in all Australian States and Territories during this time. For international protection, you need to register your trade mark in each country you want protection in. • To be registrable, a trademark must be capable of distinguishing your goods or services from other traders. It is therefore not possible to register a trade mark that is deceptively similar to an existing trademark. Furthermore a trademark that is descriptive cannot be registered. **Unregistered Trade Mark** • A common law trade mark is an unregistered trade mark which has been used (such as a brand name or in advertising) in relation to certain goods or services to such an extent that it is recognised as distinguishing the goods and services of the business using that mark from those of other businesses. Even though it is not registered, in certain circumstances the law will prevent another trader from using the same or a similar trade mark in a way which is considered unfair.
Copyright	• Copyright is a legal right given to the authors or creators of works. • Under copyright law, the copyright owner has a number of exclusive rights including the right to publish the work, control copying, prepare derivative works and perform of their work as well as the right to make the material available online. • Copyright protects the written expression of an idea or concept - it does not protect the actual idea or concept itself. • Copyright doesn't give the author of a work a monopoly over the ideas or information expressed in that work – anyone can use the ideas contained in a work provided they do not use the exact words used by the author to describe the idea or concept. • The Copyright Act protects 8 different categories of "works" and "subject matter other than works".

Type of Intellectual Property Right (continued)	Description of Intellectual Property Rights (continued)
Copyright	• Copyright protection is automatic under Australian law from the moment you place your work in a material form. This includes writing down, recording or filming your work. A work doesn't have to be published to be protected by copyright – copyright also protects unpublished works. • Australia does not have a system of copyright registration, so a work does not have to go through a registration process before it can be protected by copyright.

Ownership of Intellectual Property	
The Legal Position with Employees, Contractors and Volunteers	• As a general rule, an employer will own the intellectual property created by its employees in the course of their employment. However, intellectual property that is created by an employee, other than in the course of employment, is owned by the employee, not the employer. • In the absence of a contract to the contrary, a contractor or consultant will own the intellectual property that the contractor or consultant creates. • Generally, a volunteer owns the intellectual property that the volunteer creates. If you want ownership of the intellectual property created by the volunteer, the volunteer will need to transfer ownership of intellectual property to you through a written agreement. • It is important to show ownership of copyright and other intellectual property rights through written agreements with employees, contractors and volunteers.

Type of Clause	Employment Contracts should include these terms to protect an employer's Intellectual Property rights
NFPs and Charities	
Ownership of Intellectual Property	• That intellectual property created by the employee in the course of the employee's employment, or in relation to a certain field, is owned by the employer.
Signing Documents to Record the Employer's Ownership of Intellectual Property	• That the employee will sign any document that the employer reasonably requires (such as a deed of assignment) to record the employer's ownership of the intellectual property created by the employee in the course of employment. • This obligation needs to continue during the employment relationship, as well as after the employment relationship has ended. It may be necessary, for example, for an employee to sign patent application documents after the employment relationship comes to an end.

Confidential Information	• That in relation to the employer's confidential information the employee will:
	  • keep it confidential and will not disclose it to another person; and
	  • not use it in any manner outside the course of employment.
	• This obligation needs to continue during the employment relationship, and also after the employment relationship ends.

Type of Clause (continued)	**Employment Contracts should include these terms to protect an employer's Intellectual Property rights** (continued)

Scope of Confidential Information	• The scope of the employer's confidential information subject to those obligations needs to be broad, and include:
	  • the intellectual property created by the employee in the course of employment;
	  • other intellectual property of the employer's, including that created by other employees, in existence when the employment relationship started, or which the employer has licensed from another person; and
	  • other business information such as customer lists, supplier lists, marketing plans and strategies, business plans, financial information, etc.

Waiver of Moral Rights	• That the employee waives the employee's moral rights in relation to any works in which copyright subsists (such as computer programs).
Restraint on Competition	• Some employment contracts include a restraint on competition. • Such a restraint operates to restrain a former employee from competing with the employer, for an agreed duration, over a specified geographical area. • If the extent or scope of the restraint is too broad, operates for too long, or operates over too large a geographical area, the restraint will be invalid, and the employee will not be bound by it. • But to the extent that the restraint is reasonable, operates for a reasonable period, and over a reasonable area, it will be valid. • These restraint obligations need to apply not just during the employment relationship, but also after it ends.

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Topics from previous issues

Issue 11, Summer 2014

- Removing a Director/Committee Member
- Brand Protection
- Defining Government Entities
- Indigenous Charities
- Future of ACNC

Issue 10, Spring 2013

- Risky Business
- Due Diligence for New Directors
- Governance Standards
- Income Tax

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