

Our Ref: DFM:09/0005

The rogue directors and aggrieved member: a governance dispute within a registered charitable institution

Summary

The story concerns rogue directors and a members' meeting convened to remove them. The ensuing fracas involved lawyers acting for the rogue directors, lawyers acting for a member, a lockout of members from the charity's premises and the police.

The fracas however did not involve the Australian Charities and Not for Profits Commission ("ACNC"). The ACNC initially acknowledged it had jurisdiction to ensure the directors were accountable to members but believed the directors were "innocent until proven guilty". Regrettably, the ACNC appeared unwilling to consider material on the face of things that showed directors had failed to be accountable to members.

The fracas also raises doubts regarding the effectiveness of the charity "self-regulating" model promoted by Minister Kevin Andrews. Lawyers, police and premises lockouts suggest anarchy rather than self-regulation had prevailed, at the expense of the charity's purpose.

The story is based on a matter where we acted for a member of a registered charity, a company limited by guarantee. We call this person "the aggrieved member". For reasons that should become obvious, we call the other party, the "rogue directors".

Legal background

It may be helpful if we first describe the law relating to the matter.

Section 249F of the *Corporations Act* is a mechanism for company members to call a members' meeting. Possibly to prevent frivolous use of the mechanism, s249F requires a minimum of 5% of voting members to requisition the meeting.

The *Australian Charities and Not for Profits Commission Act* "switches off" section 249F.¹ That is, the statutory mechanism under the *Corporations Act* for members of a charitable company to call meetings is no more.

In place of s249F is ACNC governance standard 2 which requires directors to ensure: "members have an adequate opportunity to raise concerns about the governance".²

¹ see item 9, section 111L *Corporations Act*.

² regulation 45.10 *Australian Charities and Not for Profits Regulation 2013*.

Typically, constitutions of charitable companies limited by guarantee have a clause that reflects the requirements of s249F. Regardless of the statutory “switch off” for s249F, the clause acts as a contractual mechanism to convene a members’ meeting.

In the present matter, the charity’s constitution had the relevant clause. Hence members of the charity had a contractual mechanism to call a meeting.

Other law relevant for this matter is:

- Section 203E *Corporations Act* which prevents directors removing other directors.
- Section 203D *Corporations Act* which is a mechanism for members in general meeting to remove directors, providing directors have notice of the meeting and have an opportunity to speak to the meeting (amongst other requirements).

Factual outline

The aggrieved member is an honorary life member and former president of the charity. As a board member the aggrieved member had been subject to chronic generic allegations of financial mismanagement by another board member and sought our assistance. These generic allegations (that is, allegations with no apparent factual basis) could fairly be described as no more than “gossip and innuendo”.

The rogue director decisions in breach

Subsequently, the rogue directors formed an “executive director” group, resolved to abolish the “vice president” position under the charity’s constitution, and suspended the aggrieved member as a director and as a member. The rogue directors later purported to expel the aggrieved member entirely from the charity.

No disciplinary process for the aggrieved member ever took place to hear the allegations, either before or after the suspension or subsequent expulsion.

On a plain reading the rogue directors’ decision breached section 203E of the *Corporations Act*.

The aggrieved member determined that:

- They would seek support of sufficient numbers of members to convene a meeting and put motions to consider removal of the rogue directors from office.
- We should write to the ACNC quoting the rogue directors’ resolution to abolish the vice president position and suspend the aggrieved member, with reference to ACNC governance standard 2 and section 204E *Corporations Act*, together with a request to the ACNC that it investigate the charity as it saw fit.

The aggrieved member secured the numbers to convene a members’ meeting. This proposed meeting was organised and was to be convened by other members.

The ACNC's responses

In response to our letter, the ACNC acknowledged that the issue was in its jurisdiction; however the ACNC could not confirm whether it would address the issue.

Two weeks later, the aggrieved member noticed their name as a “responsible person” had been removed from the charity’s webpage at the ACNC. An inquiry to the ACNC by the aggrieved member, querying the integrity of the ACNC’s systems was acknowledged. The ACNC again stated it could not confirm how it would respond to this issue.

Seemingly fuelled by the ACNC’s lack of action, the rogue directors then issued a notice to members stating that the proposed members’ meeting was illegal. The notice made defamatory imputations against the aggrieved member (activities “possibly fraudulent”) and stated that the charity’s premises would “not be available” for the meeting.³

The ACNC was informed but did not ensure that the premises would be available to conduct the members’ meeting. Such a meeting on a plain reading was for members to raise concerns about governance, per ACNC governance standard 2.

The members’ meeting was reconvened to another venue and we were asked to attend on behalf of the aggrieved member.

More lawyers and police become involved

24 hours prior to the meeting, lawyers purporting to act for the charity but receiving instructions from the rogue directors issued a demand. The demand required the aggrieved member to give undertakings to cancel the meeting and never call such a meeting again, on pain of injunctions being issued to revoke any meeting resolutions.

We replied for the aggrieved member with an open letter. Injunctions did not issue.

The members’ meeting went ahead with care (returning officer checked proxies, ensured 5% of members were present, persons were given a time to speak, chair reiterated that directors have an opportunity to respond). Members present far exceeded the requisite quorum and resolutions unanimously approved removal of all directors including the rogue directors. New directors were appointed.

The next working day saw the new directors attend the charity’s premises to be confronted by a rogue director who then called the police.

During this confrontation and at the aggrieved member’s request, we called the ACNC to ask if it would now intervene. The ACNC officer said that as police had been called, the matter was outside their jurisdiction. The officer also said the ACNC presumes directors are innocent until proven guilty, even if there may be a breach of governance standard 2.

The police subsequently arrived but said they would not intervene either as it was a civil matter between charity members. However they required undertakings from both parties not to enter the charity’s premises until issues were resolved.

The new board arranged to temporarily freeze funds and establish an office elsewhere.

³ It was discovered later that the premises’ locks had been changed by the rogue directors so their statement that the premises would “not be available” to members was literally correct.

Opinion

The ACNC

Arguably the ACNC failed this charity.

The ACNC requires charities to abide by governance standard 2. However it also says it will not get involved in a charity's internal disputes. Inevitably though, when directors fail to be accountable to members, internal disputes arise.

The ACNC has a range of proportionate enforcement powers that it could have used to encourage the rogue directors to give members an opportunity to raise issues. The ACNC initially accepted it had jurisdiction. However it appeared to wash its hands of the issues and not get involved at all, despite having material on which to base an action.

The ACNC also did not prevent the rogue directors from altering "responsible person" details. This had the effect of affirming the rogue directors' position.

The new board had trouble changing passwords at the ACNC to update the responsible persons list. This was an issue because whilst the charity's bank agreed to freeze funds temporarily, the bank said it relies on the ASIC database for current company directors. The ACNC passes the "responsible persons" details onto ASIC to update that database.

Fortunately the new board was able to directly secure the assistance of ASIC to change company director details (using the standard ASIC form 484). ASIC's assistance was critical to securing the charity's funds. Other service providers to the new board (locksmith, security) also relied on company director details at ASIC for authority.

Keep in mind that members in general meeting had affirmed that they did not want the rogue directors to govern the charity.

Self regulation

This story on the other hand, is hardly a shining example of charity "self-manage" as is being promoted by Minister Andrews.⁴

What most likely began as an internal power struggle between board members, ended up as serious governance dysfunction requiring the intervention of members in general meeting, 2 lawyers, one acting for a member (but with the support of many members), and the other, purporting to act for the charity (but taking instructions from the rogue directors), as well as intervention by the police.

It is a possibility that both legal teams' fees may in part be paid for by the charity. The charity's activities (supporting members and others) are constrained. To put the story in context, the charity is a disability support organisation and most members have a disability.

This entire scenario is absurd and destructive for the charity, but regrettably real.

⁴ second reading speech Australian Charities and Not for Profits Commission (Repeal) (No 1) Bill 2014, 19 March 2014.

Frustratingly for members, they felt as though they could not remove and replace directors of the charity, despite attending to the procedural requirements of the *Corporations Act* and despite the appalling conduct of the rogue directors.

Derek Mortimer

24 June 2014

Post script

We provided a draft of this paper to the ACNC for comment; no formal response was received.

The new board did receive a formal letter (via our firm) from the ACNC confirming that the ACNC regarded the matter as being an internal dispute and beyond its jurisdiction. The letter (somewhat unhelpfully) suggested that the charity should aim to resolve the internal dispute “as soon as possible”.

The new board considered that the dispute had already been resolved by the convening of, and decisions at the members’ meeting. The new board was not obliged to further discuss the issue with the rogue directors and exercised discretion not to do so.

So despite the many difficulties, clear minded leadership from the new board with the interests and purpose of the charity as a whole in mind, adherence to rules, and a commitment to address members’ wishes did in the end, prevail.

Who we are

We are a Melbourne based boutique law firm with expertise in charity and not-for-profit law. Our firm aims to provide timely, technically excellent and cost effective advice to this unique sector.

Disclaimer

The information presented in this paper is of a general nature only and does not constitute legal advice or claim to provide a complete explanation of the Corporations Act or ACNC governance standards. Readers are encouraged to seek their own legal advice for their specific situation.

The opinions expressed in this paper are those of DF Mortimer & Associates.

Liability limited by a scheme approved under Professional Standards Legislation