THIRD DIMENSION

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

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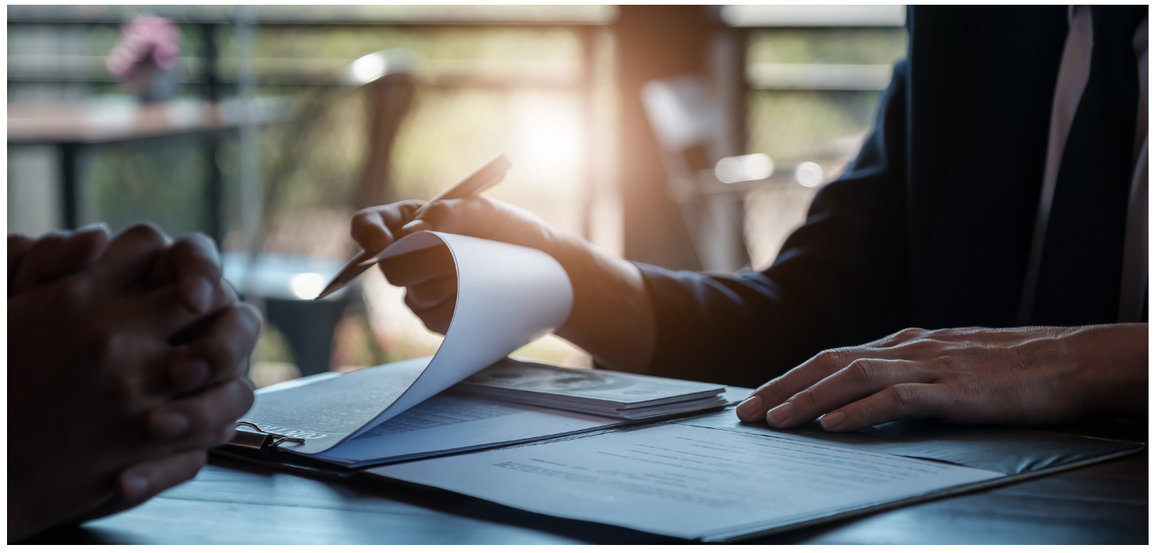
MILLS OAKLEY

Related Party Transactions & Conflicts of Interest

BY Elizabeth Shalders, Special Counsel



Conflicts of interest, conflicts of duties and related party transactions are an increasing matter of interest and focus for regulators. There is often confusion about what these terms mean, and how they should be appropriately managed. In large part, this is because the duties emerge from multiple sources:

- **Corporations Act / Incorporated associations legislation**
- **ACNC governance standards**
- **Accounting standards**
- **Case law**
- **Industry-specific regulations (e.g. school regulations)**
- **The constitution and policies of an organisation**
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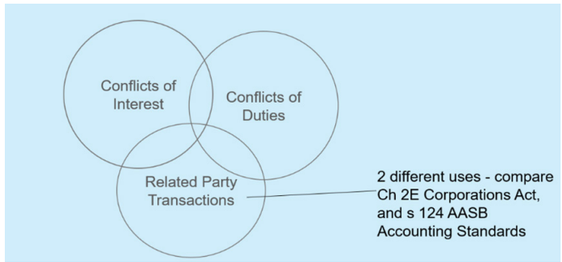
This article will provide a practical summary guide to dealing with these issues. There are five clear steps that should be taken in each case:

1. Identifying
2. Declaring
3. Managing
4. Recording
5. Reporting

It is not possible to address all the nuance or detail in this short article. An overview of key aspects only is provided.

1. Identifying

The first step is identifying when there is a conflict of interest, a conflict of duty, or related party transaction. These terms overlap but are not the same.



- A conflict of interest arises when there is a real sensible possibility that something (other than the best interests of the organisation) may influence a board member's decision-making.
- A conflict of duty can arise where a board member owes governance duties to more than one organisation or person at the same time. For example, when a person sits on two boards at the same time, or where there are mirror boards in a group structure. The duties that can be in issue are often the duties to:
  - > Act in the "best interests" of each organisation.
  - > Not to misuse information gained as a board member.
  - > Not to misuse the position of being a board member.
- The term 'related party transaction' has two different meanings in two different contexts.
  - > It is defined in the accounting standards for financial reporting purposes.
  - > It is also defined in Chapter 2E of the Corporations Act 2001 (Cth) (CA) where membership approval is required for the provision of "financial benefits" to a "related party" (with some exceptions).
  - > In both contexts the definition is long and technical. It includes (but is not limited to) directors, family members of directors and other entities within a group structure. There is a specific focus on whether one entity has "control" of another.

2. Declaring

Once an issue has been identified, the next step is to declare it. It should be declared by a board member to the rest of the board. There may also be an obligation to disclose it to members at the next members' meeting. Having in place policies which make clear to whom conflicts should be disclosed to and in what circumstances can help with clarity on this.

3. Managing

The next step is to manage the conflict of interest, conflict of duty or related party transaction appropriately. This goes to how a decision is made within the organisation.

- In the case of a conflict of interest or duty, the usual method is to ensure the conflicted board member is not participating in discussions and voting on matters related to the conflict, though there are some exceptions to this usual rule.
- In the case of a related party transaction, for public companies limited by guarantee which are not entitled to omit "limited" from their name, consider if it is necessary to follow the procedures set out in Chapter 2E of the CA.
- Depending on the specific subset of the not-for-profit sector that an organisation is operating in, there may be additional industry-specific obligations that will prohibit some transactions (for example, the not-for-profit rules applying to schools under education-specific regulations).

4. Recording

- The next step is to make a written record of the existence, declaration and management of the conflict of interest, conflict of duty and/or related party transaction.
- It should be recorded in board meeting minutes (and, where applicable, general meeting minutes). The minutes should record the nature and extent of the interest and its relevance to the organisation.
- The organisation should maintain both an interests register and a related party transaction register. Some matters will need to be recorded in both registers.
- Any related party transactions should be put in writing with clear terms (e.g. if there is a loan, there should be a loan agreement with details on the term, rate of interest and so forth).
- If Chapter 2E of the CA applies, then keep records demonstrating compliance with those requirements.

5. Reporting

The next step is reporting.

- Financial reports will need to be prepared in accordance with the accounting standards for large and medium charities. AASB 124 and 1060 have specific related party transaction reporting requirements.
- Small charities are not required to lodge financial reports with the ACNC but will still be required to disclose related party transactions in their Annual Information Statements.

There are numerous risks for organisations that fail to properly deal with these issues. It is worth investing in the development of clear policies and procedures that are tailored to your organisation and its specific context.

Australia's First Commonwealth Anti-Slavery Commissioner

BY Georgia Davis, Senior Associate

On 28 May 2024, the Australian Parliament passed the Australian Modern Slavery Amendment (Australian Anti-Slavery Commissioner) Bill 2023. The Bill is yet to receive Royal Assent but in due course will amend the Modern Slavery Act 2018 (Cth) (the MSA) which has been in force in Australia since 1 January 2019. The incoming Act will establish Australia's first ever Commonwealth Anti-Slavery Commissioner. The Commonwealth Commissioner will join the current NSW Anti-Slavery Commissioner in Australia's fight against these heinous crimes.

For anyone unfamiliar with the MSA, it is the first law in Australia compelling big businesses (including the Commonwealth government) to address Modern Slavery in a way that they were never obligated to before. The MSA requires any entity that carries on business in Australia with annual consolidated revenue of at least $100 million to provide an annual statement under the legislation. The statement must be submitted to the Department of Attorney General for publication and, among addressing other mandatory criteria, must describe the risks of Modern Slavery in the entity's own operations and supply chains (and those entities it owns/controls), and what action the entity is taking in response to those risks. In case you missed that word "publication", yes, a reporting entity's statement is published on the internet for peers, stakeholders, employees, investors, shareholders, the media and civil society to see.

This legislation is targeted at addressing a serious human rights issue impacting the lives of vulnerable people all over the world. Modern Slavery is a term used to describe only the most serious forms of exploitation including practices like human trafficking, slavery, servitude, forced labour, debt bondage, forced marriage and the worst forms of child labour. The nature and prevalence of Modern Slavery (estimated 50 million victims worldwide) means that every entity faces a real risk that it is present in operations or supply chains.

The role of a Commonwealth Anti-Slavery Commissioner will further strengthen Australia's efforts by providing an independent pillar to the current response to Modern Slavery. The Commonwealth Commissioner will be tasked with 15 functions under the incoming Act, some of which include promoting compliance with the MSA, supporting businesses in addressing their modern slavery risks and supporting victims of modern slavery. We will be watching carefully to understand the impact of the new Commissioner, whether in the form of helpful documents and information to assist reporting entities, increased pressure for action through the supply chains of big Australian businesses, or in endorsing further amendments of the MSA recommended to provide more 'teeth' for that Act, as a result of a legislative review in 2023.

Options for NFP Collaboration

BY Jonathan Salant, Associate

Collaboration can provide not-for-profits (NFPs) with opportunities to leverage the expertise, perspective, size and other capabilities of partnering organisations to deliver projects, strategies or initiatives that may otherwise be unavailable to them. This article will explore some options available for collaboration and the associated risks and benefits.

Memoranda of Understanding (MOU)

MOUs create a framework for collaboration and their primary benefit is flexibility and informality. MOUs provide organisations with opportunities to get to know one another, test the waters and either cease working together or enter into more formal arrangements .

Generally, parties to MOUs intend them to be non-binding. However, because they are drafted to reflect the informal nature of the collaboration, they can be ambiguous and lacking in detail, leading to disputes. The other common issue with MOUs it that parties may get used to dealing with one another informally and fail to manage risk by recognising when it is more appropriate for a binding contract to be drawn up (and then doing so). This risk can be managed by including review periods in the MOU where parties can consider if more formal arrangements should be entered into.

Alliances, Joint Ventures and Consortia

Alliances are informal "handshake" understandings between organisations for working together. While they are easy to establish and allow entities to leverage complimentary skills, resources and expertise they can be risky because of their informality.

Joint ventures and consortia are typically more formal and defined either through contracts or the creation of a new entity specifically for the purpose of the initiative. While they are an effective mechanism to manage risk, they can be expensive to establish.

Auspicing Agreements (AAs)

AAs involve an organisation providing funding, support or sponsorship for another (often unincorporated) entity and are a good way for established organisations to provide mentoring to new or less established NFPs. AAs are generally used in the grant funding context, because sometimes an auspicing agreement is the only way that a NFP can access funding. It is often a condition of government funding that an organisation be a registered body corporate.

However, for the auspicing entity, because they are legally responsible to the funding provider for grant acquittal, there is an increased administrative burden and need for adequate insurance and risk management.

Mergers

A merger occurs when two or more organisations are fully combined.

Mergers allow organisations to increase their reach through increased size and can reduce competition in their sector for resources or members.

Once implemented, mergers are difficult to undo. If not implemented carefully, they can also be responsible for a loss of organisational identity or purpose, leading to dysfunction amongst any (or all) of the board, staff and members.

Careful due diligence is essential before proceeding with a merger and consideration must be given to the compatibility of the participating NFPs' objects and culture; impact on charity status; viability of collaboration; reputation and financial risk.

Amalgamations

Amalgamations are a kind of merger, available to associations (or "Incs") incorporated in the same State or Territory. Amalgamations occur pursuant to the incorporated associations' legislation in that State, accordingly how they can be effected is not flexible because they are subject to statutory process.

The process is available in all jurisdictions in Australia except the Northern Territory, where a statutory transfer process can be used instead.

Nervous shock claims in historical abuse cases able to proceed

BY Raini-Eve Webber, Lawyer

On 8 February 2024, the High Court of Australia denied the Catholic Archdiocese of Melbourne ('Archdiocese') special leave to appeal the Victorian Court of Appeal's decision in *The Catholic Archdiocese of Melbourne v RWQ* [2023] VSCA 197, citing insufficient prospects of success.

Background

At first instance, Justice McDonald of the Supreme Court of Victoria ruled that s 4(2) of the Act applied to RWQ's claim and that a proper defendant nominated under s 7 could be liable for his psychological injuries. Justice McDonald held that the phrase "founded on or arising from child abuse" in s 4(2) of the Act was sufficiently broad so as to secondary victims. He concluded that excluding such claims would render the term "arising from" superfluous and would contradict the Act's intended purpose.

Primary Decision

At first instance, Justice McDonald of the Supreme Court of Victoria[1] ruled that s 4(2) of the Act applied to RWQ's claim and that a proper defendant nominated under s 7 could be liable for his psychological injuries. Justice McDonald held that the phrase "founded on or arising from child abuse" in s 4(2) of the Act was sufficiently broad so as to secondary victims. He concluded that excluding such claims would render the term "arising from" superfluous and would contradict the Act's intended purpose.

Court Appeal Decision

The Victorian Court of Appeal upheld the primary judgment, affirming that the Act "unequivocally" applies to secondary victim claims. The Court highlighted that the absence of an explicit limitation to primary victims indicates no intent to restrict the Act's application. Additionally, they noted that Justice McDonald's interpretation aligns with the Act's purpose, countering the unfairness of what has historically been known as the *Ellis*[2] defence.

Implications

The High Court's refusal to grant special leave solidifies the Victorian Court of Appeal's stance, potentially sparking an influx of secondary victim claims in Victoria. This landmark decision not only expands liability for institutions and insurers but prompts a reassessment of their liability policies. Moving forward, parties and their legal representatives should carefully consider how to document settlement discussions, particularly regarding indemnities for related secondary victim claims.

[1] RWQ v The Catholic Archdiocese of Melbourne & Ors [2022] VSC 483

[2] Trustees of the Roman Catholic Church for the Archdiocese of Sydney v Ellis & Anor [2007] NSWCA 117

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