

15 February 2013

Manager  
Philanthropy and Exemptions Unit  
Indirect, Philanthropy and Resource Tax Division  
The Treasury  
Langton Crescent  
PARKES ACT 2600

Dear Sir/Madam,

**The Australian Charities and Not-for-profits Commission Draft Governance Standards**

The Financial Services Council (FSC) welcomes this opportunity to make a submission in relation to the ACNC Draft Governance Standards.

The FSC represents Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks, licensed trustee companies and public trustees.

Within the trustee sector of their businesses, trustee members act as trustee or co-trustee for over 2,100 charitable trusts or foundations with assets of around \$3.2b.

In summary, the FSC and its members are concerned with the inappropriate application of the ACNC Draft Governance Standards to licensed trustee companies and public trustees. We believe that the practical outcomes of the governance standards and the ACNC Act do not correspond with the overarching purpose of the Act; to establish a new regulatory framework for the Not-For-Profit (NFP) sector.

The Draft Governance Standards and the ACNC Act create a new layer of regulation that applies to licensed trustee companies and public trustees that is unnecessary and conflicts with current Federal and state/territory regulatory regimes.

The FSC's submission is attached as attachment 1 to this letter. If you have any questions about the submission please do not hesitate to contact Martin Codina, Director of Policy, or myself on (02) 9299 3022.

Yours sincerely

EVE BROWN

Senior Policy Manager - Trustees

We make the following comments on the ACNC Draft Governance Standards –

The FSC has prepared a submission which –

1. Identifies the inequalities and risks associated with the scope and application of the draft governance standards and their interaction with the suspension, removal and replacement provisions in the ACNC Act;
2. Makes recommendations which would effectively minimise the potential for imbalanced outcomes and challenges to decisions made under the ACNC Act; and
3. Attaches formal advice that provides legal support for the identified issues in respect of the governance standards.

## **SUMMARY OF GOVERNANCE STANDARDS AND THE PROVISIONS OF THE ACNC ACT**

Standard 6 of the draft governance standards focuses on the duties of responsible entities to: act with a reasonable degree of care and diligence, act in good faith in the best interests of a registered entity, not to misuse the responsible entity's position, not to misuse information obtained as a result of that position, to disclose perceived or actual conflicts of interest and not to allow the registered entity to operate while insolvent.

A responsible entity of a registered entity is defined in the Act as (among other things) the trustee of a registered charitable trust or, if the trustee is a corporate trustee, the directors of the corporate trustee.

The Commissioner's suspension, removal and replacement powers, in respect of breaches of the governance standards (which will be Regulations), apply only to the responsible entity of a federally regulated entity. The responsible entity of a charitable or not-for-profit (**NFP**) entity that is not a federally regulated entity is not subject to the suspension, removal and replacement provisions for breach of the governance standards.

Federally regulated entities include incorporated entities and territory entities. Some of the state public trustees and all other charitable organisations that are not incorporated entities, unless they are a territory entity, are not federally regulated entities.

The Commissioner's suspension, removal and replacement powers enable the commissioner to remove the directors of a federally regulated entity, such as a trustee company, where in the Commissioner's opinion, there has been or is likely to be a contravention of the governance standards.

## **INEQUALITIES AND RISKS ASSOCIATED WITH THE DRAFT GOVERNANCE STANDARDS**

### **1. Removal and replacement provisions do not apply consistently to the responsible entities of all registered charitable entities**

Our key concern with the draft governance standards centres on the way in which those standards interact with Division 100 of the ACNC Act – the suspension, removal and replacement provisions. As stated above, the suspension, removal and replacement powers, in respect of a breach or potential breach of the governance standards, apply only to the registered entities of federally regulated entities.

This results in unequal treatment of the different participants in the charitable organisation/trust sector. Not only do the removal and replacement provisions apply to some groups of stakeholders and not others, they also have different degrees of practical effect on different individuals or entities.

For example, the directors of a NFP entity that is structured as a company limited by guarantee will be subject to the penalty of removal, whereas the senior members of an unincorporated NFP entity will not. We acknowledge that there is no constitutional power to extend the removal and replacement provisions to the other parts of the charitable trust sector however we submit that this does not warrant the application of these unbalanced provisions. We see no reason of policy that justifies the application of these penalty provisions to only a restricted part of the charitable trust sector.

In addition, these provisions create a dual market where one set of provisions relate to corporate or territory trustees and non-corporate state trustees are exempt from these rules. Prima facie, this places corporate and territory trustees at a disadvantage to other trustees. It should be noted that professional corporate and territory trustees assume the same role and are bound by the same legal duties as non-corporate state trustees.

The removal and replacement provisions are of even more concern where a trustee company is acting as a custodian trustee. The role of a custodian trustee is to hold the legal title to the trust property and to deal with that property upon the direction of the managing trustee. Discretionary decision making powers are vested in the managing trustee and the custodian has no influence over the exercise of that discretion. While the custodian trustee must do everything necessary to enable the managing trustee to exercise its powers the custodian must follow the direction of the managing trustee unless to do so would be in breach of trust. It is not possible for a custodian trustee to assess whether or not a managing trustee has complied with, or is likely to not comply with a governance standard, as the custodian is not a party to the decision making process. Under state legislation custodian trustees are not liable for any act or default of a managing trustee and it would be an anomaly if the Commissioner were able to remove a custodian trustee for the acts or omissions of others.

The practical effect of the penalty provisions is also disparate across the part of the sector that the provisions apply to. The practical effect of suspension and removal of the directors of a corporate trustee that is a trustee company are significantly harsher than removal of a director of an incorporated charitable entity. This is because commonly trustee companies are part of a broader corporate group structure with different companies acting in a number of capacities and as trustee for a huge range of trusts. It is not unusual for several related entities to share the same directors.

The directors of a trustee company are the responsible entities of hundreds of thousands of trusts, only some of which are registered charitable entities under the ACNC Act. The words of Division 100 grant the Commissioner the power to remove one or more directors from their directorship roles and these roles are often held in more than one company within a group of companies. If a director is suspended or removed under the terms of Division 100, then for all practical purposes the director is suspended or removed from acting as a director of any trustee company and not just in relation to the particular registered charitable entity.

The practical effect of the removal and replacement provisions is unfairly, negatively skewed to the directors of trustee companies as this group of responsible entities is the only class of entities likely to hold directorship posts at more than one company within a group. As such, not only are these provisions disproportionate in their effect on trustee companies but they are also a disproportionate punishment, able to be imposed for a potential breach of a governance standard in respect of only one particular trust.

## **2. Different standards and rules apply to the same activities**

As stated above, the directors of trustee companies and public trustees are responsible for managing hundreds of thousands of trusts. The FSC's trustee company members are licensed to act as a trustee for a range of different types of trusts, including charitable trusts. One of the key differences between trustee companies and public trustees on the one hand and charitable organisations on the other is that the management of registered charitable trust entities is only one part of the core business of trustee companies and public trustees. It is critical to note that whilst each trust must be managed individually and according to its own terms, the management activities and legal duties and obligations are the same in respect of all trusts.

The standards that currently govern the activities and duties of trustee companies and public trustees are set out in state and territory laws and Chapter 5D of the Corporations Act, though importantly, some other duties and obligations are part of the common law.

On a close examination of draft governance standard 6 we note the following:

### ***Standard 6 (a)***

Standard 6 (a) sets out a prudent person duty. Professional trustee companies and public trustees are bound by a higher professional duty than the one outlined in standard 6 (a). This lower standard is the standard that is ordinarily imposed on individual/lay trustees.

While we note that the draft document states that the proposed standards will not **generally** affect the application of higher duties or standards, we submit that it is superfluous and confusing to apply this governance standard to professional trustees. Both the higher and lower prudent person duties are intangible, legal duties that have developed over time from case law precedent. There is a significant risk that standard 6 (a) will lead to confusion in the professional trustee industry as to the appropriate duty or actions to take in respect of registered charitable entities and whether the relevant duty or actions are different to those that should be applied to all other trusts.

Individual trustees or members of non-corporate charitable organisations do not have other types of trusts to manage. They focus solely on the registered charitable entity that they have been appointed to manage and there is no risk of confusion around different standards applying to the same management activities for a range of different trusts. In addition, individual and non-corporate trustees cannot be suspended, removed or replaced for breach of the standards as they are not a federally regulated entity.

### **Standard 6 (b)**

We are particularly concerned with Standard 6 (b), which sets out a 'best interest' or fiduciary duty. The relationship between a trustee and a beneficiary (or the stated purpose of a charitable trust), of itself involves a fiduciary duty. As such, a fiduciary duty is an inherent aspect of that type of relationship and does not depend on or arise from the nature of the relationship between the parties.

Similar to the prudent person duty, professional trustees are subject to a higher fiduciary duty generally than individual trustees. This higher duty has developed over time through judge made, common law.

Not only is it not clear from standard 6 (b) whether this duty is in line with the higher or lower fiduciary duty, leading to confusion, it is also difficult to comprehend how the Commissioner will assess compliance or otherwise with this complex, intangible legal duty. If a trustee fails to act, in a significant respect, in the best interest of the beneficiary or purpose of a trust, then the trustee has acted in breach of trust. Whether a professional trustee has fallen short of the higher fiduciary duty is a question of law that has traditionally been determined by a court of equity. The supreme courts are subject to the rules of evidence and have the benefit of more than a century of precedence upon which to base decisions. A question of whether a trustee has acted in the best interests of the trust is a question that goes to the discretionary decision making of the trustee. We would like to know, on what basis will the Commissioner make a serious decision in respect of the discretionary decision making of a professional trustee, before imposing these serious penalties of suspension, removal and replacement?

In addition, a breach of this governance standard will only result in suspension, removal or replacement for the responsible entities of federally regulated entities. There is a significant risk that individual co-trustees who cannot be removed from office for breach of this governance standard will use this regulatory inequality to make complaints about their professional co-trustees who are subject to the removal and replacement provisions. This is fundamentally prejudicial as the purpose of the ACNC regime is to consistently regulate the entire NFP sector (noting also that trustee companies are stakeholder to and not part of the not-for-profit sector).

To illustrate the point we provide the following example: the Commissioner receives a complaint from an individual co-trustee of a charitable trust. The co-trustee is of the view that the investment portfolio that has been adopted by the professional co-trustee in relation to the relevant charitable trust is not in the best interests of the trust, to further the purposes of the trust. The Commissioner contacts the professional trustee who maintains that the bespoke investment portfolio is the most appropriate portfolio for the trust.

How will the Commissioner make a decision as to whether the professional trustee, in implementing and maintaining the investment approach, has discharged its higher fiduciary duty to act in the best interests of the trust? These kinds of complex, intangible, legal decisions are best made by a court that can apply the doctrine of precedence and ensure that the decision making process is, fair, transparent and independent.

In addition, the removal and replacement of a professional trustee by a third party who was not granted a power to do so within the terms of the trust instrument, is in direct conflict with the wishes of the person who created the trust. Consumers who choose to appoint a professional public trustee or trustee company to manage a charitable trust have done so on the understanding that the trustee will not be removed from office, unless of course the trustee is shown to have acted in breach of trust. To allow the Commissioner to form a view as to breach of a governance standard, and to base a decision to remove and replace the independent trustee on that view, is to interfere with the legitimate wishes of the person who created the trust.

### ***Standards 6 (c) and (d)***

Standards 6 (c) and (d) are almost identical to sections 601UAA and 601UAB of Chapter 5D of the Corporations Act 2001. This chapter applies to all licensed trustee companies in respect of all the trusts under their administration, not just charitable trusts. A breach or potential breach (in the Commissioner's opinion) of these standards may also necessarily be a breach of the aforementioned provisions of the Corporations Act. Therefore, if a licensed trustee company is considered by the Commissioner to be in breach of standard 6 (c) and/or (d), in relation to a charitable trust, then the trustee may be subject to a double penalty in respect of the same activity, under two different regimes - the civil penalty provisions in the corporations law and the suspension, removal and replacement provisions in the ACNC Act.

We also point out that individual trustees or senior members of unincorporated charitable entities will not be subject to either of these penalties even if they partake in exactly the same kind of behaviour i.e. even where they are found to have misused their position or information obtained through that position to gain an advantage. This is because the removal and replacement provisions do not apply to the responsible entities of non-federally regulated entities and these individuals and entities are not licensed under the corporations law regime.

### ***Standards 6 (e) and (f)***

Standard 6 (e) imposes a duty on a responsible entity of a federally regulated entity to disclose perceived or actual material conflicts of interest. The imposition of this standard upon trustee companies and the potential for trustee company directors to be suspended or removed from office for breach of such a standard contradicts the current state of law and practice in this area.

Unlike the directors or senior members of a charitable organisation, trustee companies are in the business of investing money. A professional trustee may legally invest trust funds in any kind of investment and there are no restrictions on the types or kinds of investments that may be chosen. Instead, the state legislatures have imposed a high prudent person duty on professional trustees so as to control and prevent investments in speculative or hazardous products.

As a matter of course trustee companies and public trustees invest trust assets in own branded and external investment products. Own branded products are provided either by the same entity as the one that is trustee of the trust or a related entity. The current state of the law accepts that trustee companies can invest trust funds in own branded products that are provided by the same or a related party whilst still acting in the best interests of the trust, to further the purposes of the trust. In fact, this concept is captured within the Private Ancillary Fund (PAF) model deed which recognises

that payments made to providers, including related parties, if they are at arms length and for market rates, are acceptable.

In order to comply with this Standard the directors of a trustee company would need to disclose each and every incidence of investment in own branded investment products, though only in relation to registered charitable trusts and not all of the other trusts under their management. Further, a failure to make such a disclosure could result in the suspension, removal and replacement of the company's directors. It is not clear who the disclosure is to be made to and in what form the disclosure should be made.

In addition, where the responsible entity of a non-corporate charitable entity fails to disclose a material conflict of interest and is found to be in breach of this standard, this person is not at risk of being suspended or removed from office. This is because a non corporate charitable entity is not a federally regulated entity.

The practical outcome of this standard will be to inundate the Commissioner with disclosures around the legal investment decisions of professional trustees whilst having almost no coercive influence on the disclosure of other responsible entities of illegal conflicts of interest. This is because a failure to make such a disclosure by the responsible entity of a non-corporate charitable entity is not met with the same strict penalty - the removal and replacement provisions.

In respect of Standard 6 (f) we submit that this standard will be problematic for trustee companies and public trustees. There are many and varied situations when a charitable trust will operate whilst it is technically insolvent. For example, the trust might incur establishment fees before the trust funds have been officially cleared into the trust account. Similarly, a trust might incur expenses or the trustee might make distributions before the sale of an asset is complete, resulting in a temporary nil or debit balance in the trust account.

This standard is clearly one that could and should apply to charitable or NFP organisations that receive funding from charitable trusts and from public donations, however in relation to trustee companies and public trustees the standard is inappropriate and impractical.

### **3. Imposition of serious and significant penalties that are not applied equally and consistently, are not proportionate to the breach and are not in line with the purpose of the ACNC Act**

The removal of a professional trustee in respect of a particular trust results in a loss of the trustee's property and damage to the trustee's reputation. The consequences that flow from a removal from the office of trustee are a significant penalty. Further, the negative consequences that would flow from removal as a director of one or more public, listed companies would be enormous.

The removal from office of a senior member or director of a non-corporate entity does not result in the same type of penalty. There would be no loss of property as these individuals do not hold paid positions and the damage to reputation would be personal, rather than commercial. In addition, the removal and replacement provisions for breach of the governance standards do not apply to the responsible entities of non-corporate charitable entities.

It is unprecedented to vest a power to impose these serious and severe commercial penalties in a body other than a court. They may be imposed only on certain groups of individuals and entities and on the basis of a perceived breach of governance standards that directly conflict with other settled principles of law.

In our view, the imposition of these penalties is inconsistent with the overarching purpose of the ACNC Act, as outlined in the Explanatory Memorandum. The legal advice that is attached to this submission provides further detail around this inconsistency.

Further, in our view, the power to impose such harsh penalties could be characterised as a judicial power and would therefore be in breach of the separation of powers doctrine. As noted in the attached legal advice, a breach of this doctrine can occur regardless of whether the relevant provisions are supported by another power in the Australian constitution.

There is a real and significant risk that if the governance standards are made law in their current form and the Commissioner at some point exercises her power to remove and replace the directors of one or more public listed companies, on the basis of a perceived breach of the governance standards, that the effected director will not only challenge the Commissioner's decision on breach but will also challenge the legality and general interpretation of Division 100.

## **RECOMMENDATIONS**

We are seeking acknowledgment of the unique position of trustee companies and public trustees in comparison to the other entities subject to the ACNC regime. Private trustee companies are licensed to provide a full suite of traditional trustee (financial) services to retail clients, of which charitable trusteeship is only one. The core business of private trustee companies and public trustees is the management of trust assets and these organisations are charged with the responsibility of managing hundreds of thousands of different trusts. Trustee companies and public trustees have been subject to a plethora of federal and state legislative rules and common law principles around the governance of trusts for more than a century. Licensed trustee companies whose core business encompasses the management of charitable and other trusts are not the same as charitable and NFP entities. They are commercial entities that are structured, operated and regulated in a completely different manner.

The practical outcomes around the removal and replacement provisions and complying with the draft governance standards simply do not fit with trustee companies and public trustees. As such we recommend exempting licensed trustee companies and all public trustees from Standard 6. Without an exemption there is a risk of confusion around legal duties and trust governance, the imposition of unequal and disproportionate penalties being imposed upon a subset of charitable trust stakeholders and legal challenges to the ACNC Act as a whole.

Alternatively we suggest the following:

1. Qualifying Standard 6 (b) by excluding from the Commissioner's jurisdiction the review of a professional trustee's exercise of discretion, except to the extent there is an allegation of bad faith, failure to give fair and proper consideration to the exercise of the discretion, or failure to exercise the discretion in accordance with the purpose for which it was conferred.

A similar exclusion is found in 5.1 (q) of the terms of reference to the Financial Ombudsman Service and was included to ensure that an exercise of a trustee's discretion in good faith is protected from a review and penalty process that sits outside of the courts.

2. Provide the Commissioner with an express discretion to decline to make a decision as to breach of a governance standard if the Commissioner considers this course of action to be appropriate because (a) there is a more appropriate place to deal with the question, such as a court or (b) the question relates to a Financial Services Provider's practice or policy and does not involve any allegation of either maladministration or inappropriate application of the practice or policy.

Again, a similar provision can be found in the terms of reference to FOS.

3. Exempting trustee companies and public trustees from all or part of Standards 6 (e) and (f). It should be made explicit in the standards document that investment by a professional trustee in own branded investment products, if they are at arms length and for market rates, are not required to be disclosed to the Commissioner or any other person or entity.

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Matter 82066161

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Dear John and Eve

## **Advice regarding the removal and suspension of trustees and directors of corporate trustees pursuant to the ACNC Act**

### **1 Introduction**

#### **1.1 Background**

You have instructed us to provide an advice in relation to the suspension and removal of trustees and the directors of corporate trustees pursuant to the *Australian Charities and Not-for-profits Commission Act 2012* (Cth) (**ACNC Act**), which was passed by both houses of the Commonwealth Parliament on 1 November 2012, and received Royal Assent on 3 December 2012.

The ACNC Act vests the Commissioner of the Australian Charities and Not-for-profits Commission (**Commissioner**) with powers to remove or suspend the responsible entity of a registered entity for breach of (or in certain circumstances a likely breach of):

- 1 the ACNC Act;
- 2 a governance standard; or
- 3 an external conduct standard.

As at the date of this advice, the Governor-General has not made any regulations in relation to the ACNC Act, however Treasury is currently consulting in relation to the exposure draft of the governance standards.

#### **1.2 Executive Summary**

##### **(a) Breach of the ACNC Act or governance standards**

In the case of a breach, or likely breach, of the ACNC Act or the governance standards, the Commissioner may only remove or suspend the responsible entity of a *federally regulated entity*, being:

- 1 the trustee of a charitable trust that is a constitutional corporation;



- 2 the directors of a corporate trustee acting as trustee of a charitable trust; or
- 3 the responsible entity of a Territory-related charitable trust.

In our opinion, these powers apply in relation to the public trustees of the Territories and may apply in relation to the public trustees in each of the states, depending on whether the state public trustees are ‘trading or financial corporations’ within the meaning of section 51(xx) of the Constitution of Australia.

This constitutional limitation on the power generates the potential for uncertainty in the applicability of the removal powers for certain types of trustees.

**(b) Breach of the external conduct standards**

In the case of a breach, or likely breach, of the external conduct standards, the Commissioner may remove or suspend the responsible entity of *any* registered entity (not just a *federally regulated entity*).

This broader class of regulated entities in relation to external conduct standards, compared to the narrower class of regulated entities in relation to breaches or likely breaches of the governance standards and the provisions of the ACNC Act, raises the potential for confusion in the regulation of trustees and the creation of a dual market.

**(c) Nature of the Commissioner’s removal / suspension powers with regard to corporate trustees and comparison to ASIC’s powers**

From a constitutional law perspective, the exercise of the Commissioner’s powers could be viewed as an exercise of a judicial or quasi-judicial power. If this view is adopted, this could leave the exercise of the power subject to a constitutional challenge.

The removal powers vested in the Commissioner are more extensive than those of the Australian Securities and Investments Commission (**ASIC**). By way of comparison:

- In certain cases, ASIC is only able to remove directors by application to the court and significantly, the court is the final arbiter. However, in the context of the ACNC Act, the Commissioner may exercise the removal powers without the involvement of the court, which means that the protections afforded by the application of the rules of evidence and doctrine of precedent would be lacking. In our view, this creates uncertainty and potential for unfairness.
- The Commissioner’s powers to remove directors generally apply to less serious circumstances and less serious breaches or likely breaches of the ACNC Act, the governance standards or the external conduct standards.
- Unlike the Commissioner, ASIC cannot disqualify a person for something that has not yet occurred as a preventative measure.

The stated intention behind the ACNC Act is to offer powers that are proportionate to the non-compliance and a “targeted” enforcement mechanism. However, the powers of the Commissioner are broad (and extend to breaches of governance standards) and have wide-reaching consequences. Removing a director of a corporate trustee under the ACNC Act is very significant and denies the director the ability to participate in any other trust appointments or other corporate activities and roles of that corporate trustee.

**(d) Commercial consequences**

The uncertainty relating to, and the potential for unfairness in, the application of the wide suspension and removal powers must be a commercial concern for trustees and may deter companies and directors of corporate trustees from taking on or continuing with charitable trust appointments. We expect that this is particularly so for corporate trustees and professional trustee companies, where corporate entities commonly have multiple roles and activities (that is, they are not limited to one charitable trust role).



We fear that there will be a tipping point at which trustees are not willing to accept these risks and will seek to exit the charitable trustee business. We anticipate that if professional trustees exited the market, this would result in a net reduction in the number of trustees which in turn would decrease competition and decrease pricing pressure and could also lead to a reduction in service standards and the levels of experience in the market as a whole. Such an outcome would not be consistent with the general aims of the ACNC Act.

### **1.3 Overview of professional corporate trustees and public trustees in Australia**

#### **(a) Overview of charitable structures**

The two types of charities that exist in Australia are:

- 1 Charitable funds; and
- 2 Charitable institutions.

A charitable fund is established pursuant to a trust instrument or a will, and must have a charitable purpose. The fund will hold and manage trust property, as well as make distributions to charitable institutions or individuals. On the other hand, a charitable institution is a NFP organisation, which is established and run for the advancement of a charitable purpose. Accordingly, the primary purpose of a charitable institution is to conduct charitable work.

#### **(b) Professional corporate trustees**

There are a number of professional trustee companies operating in Australia that act as trustees of charitable trusts. Commonly, professional trustee companies are part of a broader corporate group structure. Under such a structure there are multiple entities within a group of companies, one of which is the company appointed as the trustee of a particular charitable trust. It is not unusual in this type of structure to have common directors across the related bodies corporate. Consequently, the directors of the corporate trustee may also be the directors of a number of related bodies corporate within the group. In addition, the professional corporate trustee itself may act in a number of capacities and as trustee of a number of trusts, which may include charitable trusts as well as non-charitable trusts.

#### **(c) Public trustees**

The other major participants in the charitable trust industry are the public trustees of each state and territory of Australia. The public trustees offer a range of services for which they charge fees, including assisting with the establishment of trusts, providing advice in relation to wills, preparing powers of attorney, managing estates and acting as trustee for various kinds of trusts.

The public trustees are created by state and territory legislation, which governs their structure and operation. The structure of the public trustees will be examined in section 2.3(a) below.

## **2 Overview of the ACNC Act in relation to the suspension and removal of trustees**

### **2.1 Legislative Purpose**

The objectives of the ACNC Act are discussed and analysed in detail below. However, by way of introduction, we note that the objects of the ACNC Act are:

- “to maintain, protect and enhance the public trust and confidence in the NFP [not-for-profit] sector;
- to support and sustain a robust, vibrant, independent and innovative NFP sector; and



- to promote the reduction of unnecessary regulatory obligations on the NFP sector.”<sup>1</sup>

## 2.2 Relevant provisions of the ACNC Act

### (a) Registration pursuant to the ACNC Act

In pursuance of the above objectives, the ACNC Act provides for the registration of not-for-profit (**NFP**) entities that fall within the prescribed categories of charities.<sup>2</sup> The particular categories of charities that a NFP entity is able to be registered as, reflect the trust law definition of a charitable purpose, and include an:

- entity with a purpose that is the relief of poverty, sickness or the needs of the aged;
- entity with a purpose that is the advancement of education;
- entity with a purpose that is the advancement of religion;
- entity with another purpose that is beneficial to the community;
- institution whose principal activity is to promote the prevention or the control of diseases in human beings;
- public benevolent institution; or
- entity with a charitable purpose of providing child care services.<sup>3</sup>

Divisions 25 and 30 of the ACNC Act govern the registration of NFP entities, which is a pre-requisite to an entity’s ability to obtain certain Commonwealth tax concessions.<sup>4</sup> Although registration is voluntary, the consequences of failing to successfully apply for registration, or having registration revoked in accordance with Division 35 of the ACNC Act, are that the relevant tax concessions (as well as other benefits and concessions provided under Australian law) will not be available to the NFP entity.<sup>5</sup> Where an entity is registered under the ACNC Act, it is referred to in the statute as a “registered entity”.

There are a number of pre-conditions to registration (and maintaining registration) set out in Division 25 of the ACNC Act, which include that the entity must comply with the governance standards and external conduct standards (which are governed by Part 3-1 of the ACNC Act).<sup>6</sup>

### (b) Governance and external conduct standards

The governance standards are “the minimum standards that entities are required to meet”,<sup>7</sup> and are the “set of practices and procedures in place to ensure that an entity operates to achieve its objectives in an effective and transparent manner.”<sup>8</sup>

On the other hand, the external conduct standards are minimum standards that relate to “(a) matters external to Australia; or (b) matters not external to Australia but that are

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<sup>1</sup> Explanatory Memorandum of the ACNC Act (**Explanatory Memorandum**), paragraph 1.80; ACNC Act, subdivision 15-5(1). See Explanatory Memorandum, Chapter 1 for further information regarding the objects of the ACNC Act.

<sup>2</sup> ACNC Act, subdivision 25-5(5).

<sup>3</sup> ACNC Act, subdivision 25-5(5) (column 2).

<sup>4</sup> ACNC Act, subdivision 15-5(3); Explanatory Memorandum paragraph 1.82.

<sup>5</sup> ACNC Act, subdivisions 15-5(3) and (4); See generally Chapter 3 of the Explanatory Memorandum.

<sup>6</sup> ACNC Act, subdivisions 25-5(3)(b), 45-10 and 50-10.

<sup>7</sup> ACNC Act, subdivision 45-1.

<sup>8</sup> Explanatory Memorandum of the ACNC Act, paragraph 5.5.



closely related to, or have or will have a significant impact on, entities, things or matters external to Australia.”<sup>9</sup>

The governance standards or external conduct standards are to be made by regulations,<sup>10</sup> and before making any such regulations, the Governor-General is required to ensure that an appropriate consultation process has been undertaken.<sup>11</sup> We note that as at the date of this advice, the Governor-General has not made any regulations in relation to the ACNC Act. However, in December 2012 a consultation paper on the ‘Development of Governance Standards’ (**Governance Paper**) was released for public comment.

While the Governance Paper raises many issues, purely from a ‘legal principle’ perspective we draw your attention to the best interests duty in draft governance standard 6 – duties of responsible entities.

Draft governance standard 6 requires a registered entity to take reasonable steps to ensure that its responsible entity “acts in good faith in the best interests of the registered entity, to further the purposes of the registered entity”.

While the restatement of this general trust law duty is in itself uncontroversial, the effect of a breach of this duty (as a governance standard) under the ACNC Act goes far beyond the consequences pursuant to general trust law, and in our view, far beyond the powers conferred in other comparative regulatory regimes.

As discussed in detail below, the Commissioner is granted the power to suspend or remove a responsible entity of a registered entity if the Commissioner reasonably believes that the registered entity has not complied with, or is more likely than not to not comply with, a governance standard.

The concerns with the inclusion of this duty as a governance standard are:

- First, at general law, a breach of the best interests duty can only be determined by the court, with the protections provided by the applicable rules of evidence and legal precedent. In the ACNC Act context, a decision can be made by the Commissioner, who is not bound to apply the doctrine of precedent or the rules of evidence. Consequently, there is a great deal of uncertainty, and the potential for unfairness, in relation to how the power will be applied and in relation to the outcome of a determination. By way of comparison, in legislation governing superannuation trustees, while the best interests duty is restated as a covenant that is deemed to be included in the governing rules of a superannuation entity, even the Australian Prudential Regulation Authority is not granted the power of removal of a trustee where that covenant is breached.
- Second, even where at general law a trustee has been found to have breached a duty (whether it is the best interests duty or otherwise), the available remedies are an award of equitable compensation or an account of profits (or even an injunction prior to a breach) in favour of the beneficiaries of the trust. The court will only act to remove a trustee in exceptional circumstances.
- Third, at general law, the scope of the best interests duty is modified by the terms of the relevant trust instrument, which of course requires the court to review and interpret the relevant trust instrument. This raises the issue of whether the review and interpretation of the trust instrument (where relevant) will be a function assumed by the Commissioner. If so, the protections implicit in a court process will also be negated.

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<sup>9</sup> ACNC Act, subdivision 50-1.

<sup>10</sup> ACNC Act, subdivisions 45-10 and 50-10.

<sup>11</sup> ACNC Act, subdivisions 45-15 and 50-15.



- Finally, at general law, where the relevant trustee's action that is called into question involves an exercise of a discretion, the courts' power of review is limited, as the intention of the settlor is that the trustee exercises the relevant discretion personally. A decision of the trustee must be made for proper purposes, with real and genuine consideration and not irresponsibly, wantonly or capriciously. Ultimately, the trustee's decision must fall within the range of decisions that a reasonable trustee in the position of the relevant trustee would make. Significantly, the court does not conduct a 'merits review' of the trustee's decision. In our view, as the Commissioner is not bound by a system of legal principle and precedent, there is a significant danger that the review of a discretionary decision against the best interests governance standard will simply result in a merits review (which may result in the removal of the responsible entity).

**(c) Powers of removal and suspension**

Division 100 of the ACNC Act sets out the powers of removal and suspension of the "responsible entity" of registered entities that are vested in the Commissioner (**Suspension and Removal Powers**). Section 2.3 below considers how the concept of a "responsible entity" has been defined. Broadly, the concept includes the trustee of a charitable trust that is a constitutional corporation (or that is Territory-related), or the directors of the corporate trustee.

The ACNC Act provides the Commissioner with the power to suspend or remove a responsible entity of a registered entity that is federally regulated if the Commissioner reasonably believes that the registered entity:

- has contravened, or is more likely than not to contravene, a provision of the ACNC Act; or
- has not complied with, or is more likely than not to not comply with, a governance standard.<sup>12</sup>

In addition, the Commissioner may remove or suspend a responsible entity of *any* registered entity (as opposed to one that is federally regulated) where the Commissioner reasonably believes that the registered entity has not complied with, or is more likely than not to not comply with, an external conduct standard.<sup>13</sup> In making her decision to remove the responsible entity, the Commissioner must take into account the matters in subdivision 35-10(2), which, amongst other things, include the obligation to consider:

- the nature, significance and persistence of any contravention with the ACNC Act or non-compliance with a governance standard or external conduct standard (or any such contravention or non-compliance that is more likely than not) by the registered entity;
- the possible actions that may be taken by the Commissioner or the registered entity to address the contravention or non-compliance, or to prevent it;
- the objects of any Commonwealth laws that refer to registration under the ACNC Act; and
- any other matter that the Commissioner considers relevant.

However, the Suspension and Removal Powers of the Commissioner can only be exercised if the Commissioner considers that doing so is necessary to address the contravention or non-compliance (or to prevent a contravention that is more likely than

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<sup>12</sup> ACNC Act, subdivisions 100-5(1)(a)-(b), 100-10 and 100-15.

<sup>13</sup> ACNC Act, subdivisions 100-5(1)(c), 100-10 and 100-15.

not).<sup>14</sup> This 'necessity test' applies in addition to the fact that the Commissioner must reasonably believe that there has been, or will be, a contravention.

The Commissioner is required to provide the responsible entity with a written notice, which sets out the Commissioner's decision, the Commissioner's grounds for suspending or removing the responsible entity and the effect of the suspension or removal (that is, that subdivision 100-125 prohibits a suspended or removed responsible entity from managing the registered entity).<sup>15</sup> In the case of a suspension, the notice must also disclose the time frame of the suspension.<sup>16</sup>

Before making the suspension or removal, the Commissioner must provide the responsible entity with a written 'show cause notice', stating the basis of the suspension or removal and inviting the registered entity to show cause within 28 days why the Commissioner should not suspend or remove the responsible entity.<sup>17</sup> However, where the Commissioner believes on reasonable grounds and taking into account the matters set out in subdivision 35-10(2) (as outlined above) that it would be appropriate to suspend or remove the responsible entity without giving a show cause notice, the Commissioner is not under an obligation to give such notice to the registered entity.<sup>18</sup>

Following the suspension of the responsible entity, it must not again become a responsible entity of the registered entity until the suspension ends.<sup>19</sup> In the case of the removal of a responsible entity, the responsible entity is prohibited from again becoming a responsible entity of the registered entity.<sup>20</sup> There are also criminal penalties that are provided for in the ACNC Act for making or participating in making decisions that affect the business of the registered entity.<sup>21</sup>

Importantly, specific provision is made for a director of a responsible entity to cease being a director where that individual is a director of a suspended responsible entity that is a company or a corporate trustee of a trust for the duration of the suspension.<sup>22</sup> On the other hand, where a responsible entity that is a company or a corporate trustee of a trust is removed, subdivision 100.20(3) also provides for the removal of the director. In this case, there is no time limit that is placed on the removal of the director from the directorship of the company.<sup>23</sup>

#### **(d) Appealing the Commissioner's decision to suspend or remove the responsible entity**

Where a responsible entity is dissatisfied with the Commissioner's decision to remove or suspend it (an **administrative decision**), Part 7.2 of the ACNC Act provides a review and appeal mechanism through which they can object.<sup>24</sup> The entity is required to lodge its objection in the approved form within 60 days after it receives a notice of the decision.<sup>25</sup> It

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<sup>14</sup> ACNC Act, subdivisions 100-10(1) and 100-15(1).

<sup>15</sup> ACNC Act, subdivisions 100-10(3)-(5) and 100-15(2)-(4).

<sup>16</sup> ACNC Act, subdivisions 100-10(3)(c).

<sup>17</sup> ACNC Act, subdivisions 100-10(4)-(6) and 100-15(3)-(5).

<sup>18</sup> ACNC Act, subdivisions 100-10(6) and 100-15(5).

<sup>19</sup> ACNC Act, subdivision 100-20(1).

<sup>20</sup> ACNC Act, subdivision 100-20(2).

<sup>21</sup> See ACNC Act, subdivision 100-25.

<sup>22</sup> ACNC Act, subdivision 100-20(3).

<sup>23</sup> ACNC Act, subdivision 100-20(3).

<sup>24</sup> ACNC Act, subdivision 155-5.

<sup>25</sup> ACNC Act, subdivision 160-10.

is then the Commissioner's decision whether to allow (wholly or in part) or to disallow the objection (the **objection decision**).<sup>26</sup>

Where the entity is dissatisfied with the objection decision, it may apply either to the Administrative Appeals Tribunal<sup>27</sup> for review of the objection or to appeal against the objection decision to a designated court.<sup>28</sup>

In the case of a court appeal, the appeal must be lodged within 60 days of the entity receiving notice of the objection decision.<sup>29</sup> The court may make such order as it thinks fit, including confirming or varying the decision,<sup>30</sup> and the Commissioner must take such action as is necessary to give effect to the decision within 60 days after the court's decision is final.<sup>31</sup>

### 2.3 Who do the removal and suspension provisions apply to?

The Commissioner's Suspension and Removal Powers apply to the responsible entity of a "federally regulated entity", except in the case of a breach or likely breach of the external conduct standards, which applies to responsible entities of all registered entities (not just federally regulated entities).

A federally regulated entity is any of the following:

- a constitutional corporation;
- a trust (where all of the trustees of the trust are constitutional corporations);
- a body corporate taken to be registered in a Territory pursuant to section 119A of the Corporations Act;
- a trust, if governed and administered under the law of a Territory; or
- an entity that has its core or routine activities carried out in or in connection with a Territory.<sup>32</sup>

A constitutional corporation is defined in the ACNC Act to be a corporation that is either a corporation that section 51(xx) of the Constitution of Australia (**Constitution**) applies to, or a body corporate incorporated in a Territory of Australia. The limitation to constitutional corporations and territories is a reflection of the constitutional basis of the ACNC Act, which is discussed in section 6 below.

As noted above, it is the responsible entity of a federally regulated entity or registered entity, as the case may be, that is suspended or removed pursuant to Division 100 of the ACNC Act, and not the federally regulated or registered entity itself. A responsible entity of a registered entity may include each of the following:

- where the registered entity is a company – a director of the registered entity;
- where the registered entity is a trust – the trustee of the registered entity, and if the trustee is a body corporate, a director of the trustee; or

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<sup>26</sup> ACNC Act, subdivision 160-10.

<sup>27</sup> Where the review is by the AAT, the Administrative Appeals Tribunal Act 1975 will apply (as modified by Division 165 of the ACNC Act): ACNC Act, subdivision 165-5.

<sup>28</sup> ACNC Act, subdivisions 160-25 and 300-5. The designated court is the Federal Court or a Supreme Court of a State or Territory that has jurisdiction in relation to matters arising under the ACNC Act.

<sup>29</sup> ACNC Act, subdivision 170-5.

<sup>30</sup> ACNC Act, subdivision 170-15.

<sup>31</sup> ACNC Act, subdivision 170-20.

<sup>32</sup> ACNC Act, subdivision 205-20

- a person who is acting as a trustee in bankruptcy of the registered entity, an administrator or receiver of the registered entity, or other similar positions as listed in subdivision 205-30(c) of the ACNC Act.<sup>33</sup>

Accordingly, it is these entities that are the subject of the Commissioner's Suspension and Removal Powers. Based on the current wording of the legislation, where the Commissioner suspends or removes a responsible entity that is a trustee, the suspension or removal only applies with regard to the particular registered entity that is given the show cause notice. However, where the responsible entity that is removed is a director of a corporate trustee, the director would be removed from his/her directorship role (which in turn means that the director would not participate in the trusteeship of any other trust that the corporate trustee serves as trustee or in any other activity of that corporate trustee).<sup>34</sup>

Set out below is further description of how these provisions apply to trustees (including public trustees) and directors of corporate trustees.

**(a) Application of provisions to trustees**

It does not follow from the ACNC Act that trustees of all trusts may be removed or suspended by the Commissioner pursuant to Division 100. In the case of contraventions, or contraventions that are more likely than not, of the provisions of the ACNC Act or the governance standards, it is only the trustee of a registered entity that is a federally regulated entity that may be removed or suspended by the Commissioner. The key question as to whether a trustee may be removed or suspended by the Commissioner in these circumstances is therefore whether the registered entity that the trustee is acting for is a federally regulated entity. Importantly, the trustees that could be removed or suspended are trustees who:

- are constitutional corporations as defined in subdivision 205-20 of the ACNC Act (such as professional corporate trustees, trustees that are body corporates incorporated in a Territory, and potentially certain state public trustees);
- act in their capacity as trustee for a body corporate taken to be registered in a Territory pursuant to section 119A of the Corporations Act (that is, where the application pursuant to registration specifies a Territory or where a company is registered on the basis of Territory law pursuant to section 5H of the Corporations);<sup>35</sup>
- act in their capacity as trustee for a trust governed and administered under the law of a Territory (essentially, a trust created in the Australian Capital Territory, or Northern Territory); or
- act in their capacity as trustee for an entity that has its core or routine activities carried out in or in connection with a Territory.<sup>36</sup>

At least in the case of the Territories, the Removal and Suspension Powers of the Commissioner will apply to the majority of trusts that are registered entities.

However, outside the Territories and in relation to the states of Australia, the application of the Commissioner's powers is limited to trustees that are constitutional corporations. Accordingly, the provisions will apply to any corporate trustees, as well as the public trustees that are considered to be constitutional corporations. The discussion in section 2.3(b) below regarding the removal and suspension of directors of corporate trustees is also relevant to these entities.

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<sup>33</sup> ACNC Act, subdivision 205-30.

<sup>34</sup> ACNC Act, subdivision 100-20(3).

<sup>35</sup> Corporations Act, sections 5H(4)(b), 117(2)(n), 119A and 601BC(2)(o).

<sup>36</sup> ACNC Act, subdivision 205-20



In our opinion, the Commissioner's Suspension and Removal Powers apply to the public trustees of the Territories. In addition, the powers may also apply to the public trustees in each of the states. Whether the Suspension and Removal Powers apply to a state public trustee will turn on the determination of the constitutional issue as to whether the state public trustee is considered to be a 'trading or financial corporation' within the meaning of section 51(xx) of the Constitution.

State public trustees that are not constitutional corporations, fall outside the scope of the Commissioner's Removal and Suspension Powers.

The Commissioner's Removal and Suspension Powers that apply in relation to a breach or likely breach of the external conduct standards are, however, broader as all trustees (including, but not limited to, professional corporate trustees and the public trustees of each state and Territory) of entities registered under the ACNC Act could be suspended or removed by the Commissioner. That is, unlike the situation with regard to the contravention or likely contravention of the ACNC Act or the governance standards, the Commissioner's powers are not limited to responsible entities of federally regulated entities.

**(b) Application of provisions to directors of corporate trustees**

As noted above, where a trustee is a body corporate, the responsible entity of a registered entity includes not only the trustee itself, but also the directors of the trustee.<sup>37</sup> The Commissioner's Suspension and Removal Powers therefore have application to the trustee acting as responsible entity and the individual directors of the trustee company. Accordingly, this would enable the Commissioner to remove the directors of the trustee company where there has been a contravention, or there is more likely than not to be contravention, of the ACNC Act, the governance standards or external conduct standards.<sup>38</sup>

### **3 Intention and policy underlying the ACNC Act**

#### **3.1 Intention and policy underlying the ACNC Act**

The Explanatory Memorandum for the ACNC Act (**EM**) and the Assistant Treasurer and Minister Assisting for Deregulation's second reading speech delivered on Thursday 23 August 2012 (**Second Reading Speech**) demonstrate the legislature's stated intention and policy underlying the ACNC Act, and in particular, the intention and policy underlying the provisions that vest the Commissioner with the power to remove and suspend trustees and directors of corporate trustees.

The stated objects of the ACNC Act are as follows:

- "to maintain, protect and enhance the public trust and confidence in the NFP sector;
- to support and sustain a robust, vibrant, independent and innovative NFP sector; and
- to promote the reduction of unnecessary regulatory obligations on the NFP sector."<sup>39</sup>

The Second Reading Speech also states that the ACNC Act was introduced to "strengthen and support the [charitable and not-for-profit] sector, so it can continue to grow and flourish into the future... A regulatory system that promotes good governance, accountability and transparency for NFP entities will help to maintain, protect and

<sup>37</sup> ACNC Act, subdivision 205-30(b).

<sup>38</sup> ACNC Act, subdivision 100-5.

<sup>39</sup> Explanatory Memorandum, paragraph 1.80; ACNC Act, subdivision 15-5(1). See Explanatory Memorandum, Chapter 1 for further information regarding the objects of the ACNC Act.



enhance the public trust and confidence that underpins the sector.” In addition, the EM and the Second Reading Speech both discuss the benefits of having one body (the Australian Charities and Not-for-profits Commission (**ACNC**)) regulating NFP entities and the registration process for obtaining tax concessions.<sup>40</sup>

In relation to the Commissioner’s powers, the Second Reading Speech states that the powers and sanctions available to the Commissioner allow the Commissioner to “conduct regulatory oversight in an effective manner... There are preconditions and thresholds which must be met before these powers can be exercised”.

The EM explains that the enforcement powers will be used where the ACNC’s educative function does not achieve its objectives,<sup>41</sup> and that they are vested in the Commissioner to “assist in maintaining, protecting and enhancing public trust and confidence in the sector’s new regulatory framework.” Importantly, it is stated that “[t]he range of enforcement powers this Bill provides enables the ACNC to take strong, proportional and targeted actions to address actions or lack of actions that could threaten public trust and confidence in the NFP sector.”<sup>42</sup> However, the EM suggests that the ACNC will seek to minimise and address non-compliances through education, and will only use the enforcement powers for “serious and significant wrong-doing”<sup>43</sup> (for example where “an entity has persistently failed to meet regulatory obligations”).<sup>44</sup>

The “reasonably believes” test contained in subdivision 100-5 is purported to act as a benchmark that the Commissioner must meet before the Removal and Suspension Powers may be exercised. The EM explains that the Commissioner must not act if the information regarding compliance with the ACNC Act, governance standards or external conduct standards is “inconclusive, or does not clearly point to a likely contravention or case of likely non-compliance.”<sup>45</sup>

In addition, where the Commissioner is going to suspend or remove on the grounds that a contravention is “more likely than not”, the information relied upon should be reliable and the circumstances that suggest a possible contravention should not be temporary and rectifiable with discretionary action.<sup>46</sup> A rumour or mere suspicion is stated to be insufficient grounds on which to exercise the removal and suspension powers, as reliable and accurate evidence is required which indicates that there will be a contravention.<sup>47</sup>

The “necessity clauses” contained in clauses 100-10(1) and 100-15(1) are also aimed at safeguarding from the misuse of power.<sup>48</sup>

Further, in relation to the effect of the removal or suspension, the EM states that it is only effective in relation to the “position or office which led the entity to be considered a responsible entity for the purposes of [the ACNC Act]”.<sup>49</sup>

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<sup>40</sup> See Second Reading Speech and Explanatory Memorandum, Chapter 1.

<sup>41</sup> Explanatory Memorandum, paragraph 9.4.

<sup>42</sup> Explanatory Memorandum, paragraph 9.5. See also paragraph 9.24.

<sup>43</sup> Explanatory Memorandum, paragraphs 9.10, 9.18 and 9.19.

<sup>44</sup> Explanatory Memorandum, paragraph 9.30.

<sup>45</sup> Explanatory Memorandum, paragraph 9.37.

<sup>46</sup> Explanatory Memorandum, paragraphs 9.41 and 9.43.

<sup>47</sup> Explanatory Memorandum, paragraph 9.202.

<sup>48</sup> Explanatory Memorandum, paragraphs 9.45-9.47.

<sup>49</sup> Explanatory Memorandum, paragraphs 9.235.

### 3.2 Assessment of the inconsistencies between the stated intention and policy and the effect of the ACNC Act

Although the legislative policy and intent are set out in the EM and Second Reading Speech, it is necessary to consider whether this is reflected on the face, and in the substance, of the legislation.

In a number of places in the EM, references are made to the fact that the powers are proportionate to the non-compliance. However, on a close examination of subdivisions 100-5 - 100-15, in our view, it is clear that this is not reflected on the face of the legislation. As a matter of statutory interpretation, although the EM may make this pronouncement, unless there is some ambiguity or confusion caused by adopting the ordinary meaning of the legislation, a court would not be able to depart from the ordinary meaning of the provisions of the ACNC Act by referring to the EM.<sup>50</sup>

The Commissioner is not only able to remove or suspend the trustee or directors of a corporate trustee for a breach of the Act, governance standards or external conduct standards, but is able to make the removal or suspension for a contravention that is more likely than not. Additionally, the contraventions of the governance and external conduct standards could be minor in nature, yet the Commissioner could still exercise the removal and suspension powers. In our opinion, the current drafting of these provisions provides the Commissioner with the power to act disproportionately to the nature of the contraventions (or potential contraventions).

Although the EM provides that the removal or suspension is only in relation to the position that formed the basis of the application of the ACNC Act to the responsible entity,<sup>51</sup> in practice, a director is removed or suspended from acting as a director of the trustee company in all circumstances, and not just those in relation to the responsible entity. Accordingly, there are significant repercussions to the removal or suspension of a director of a corporate trustee that acts as trustee for multiple trusts (including trusts that are not registered under the ACNC Act) or has other roles or functions as a corporate entity, as it would prevent the individual acting as a director of the corporate trustee in relation to all of the trusts and for all other corporate purposes. The practical effect of the removal or suspension could therefore extend well beyond the particular capacity as trustee of the registered entity. In our opinion, this is another area which demonstrates that the powers provided to the Commissioner are inconsistent with the stated legislative intention and policy underlying the ACNC Act.

In addition, the removal or suspension of directors for all purposes in this way also fails to provide a “targeted” enforcement mechanism as the consequences of the removal or suspension extend beyond the directors’ capacity in relation to the relevant charitable trust, despite this being the stated intention of the ACNC Act.<sup>52</sup>

Additionally, the EM appears to suggest that the removal or suspension powers are a matter of last resort as the focus is on the educational aspects and on preventing non-compliance. In our opinion, this is not apparent from an examination of the provisions contained in Division 100, as the Commissioner is able to remove for possible contraventions that have not yet occurred. There is the potential in these circumstances for the removal or suspension powers to be used in much wider circumstances than those propounded by the EM.

As noted in section 3.1 above, the EM suggests that there are a number of limitations on the Commissioner’s use of the removal and suspension powers, including that the information relied upon must be conclusive or reliable in order to exercise the powers

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<sup>50</sup> *Acts Interpretation Act 1901* (Cth), section 15AB(1).

<sup>51</sup> Explanatory Memorandum, paragraph 9.235.

<sup>52</sup> Explanatory Memorandum, paragraph 9.5.



before a contravention has actually occurred. However, this is not entirely clear from the drafting of the legislation in that although the Commissioner must form a “reasonable” belief that a contravention is more likely than not to occur, the actual exercise of the power is based on the Commissioner’s actual belief that the removal or suspension is “necessary” to prevent the breach. In our opinion, this demonstrates another inconsistency between the drafting of the ACNC Act and the stated intention and policy underlying it.

#### **4 Comparison with existing law regarding the removal of directors of corporate trustees**

##### **(a) Removal of directors pursuant to corporations law**

Generally, the removal of directors is governed by the Corporations Act and the particular constitution of a company. Many trustee companies are publicly listed companies that hold an Australian financial services licence in connection with the provision of traditional trustee services.

The default position in relation to proprietary companies under the Corporations Act (which is a replaceable rule that can be displaced by a provision in the company’s constitution that provides otherwise) is that the company may, by resolution, remove a director from office and appoint another in the directors place.<sup>53</sup> Accordingly, at a general meeting of members, an ordinary resolution could be passed to this effect.

With regard to public companies, the board is prohibited from removing a director and despite anything in the company’s constitution, an agreement between the company and director, or an agreement between the members and the director, a director may only be removed by a members’ resolution.<sup>54</sup> In addition, section 203D of the Corporations Act provides for special notice of intention to move a resolution to remove the director, of at least two months.

Accordingly, under the general principles of corporations law, it is the members of public companies who have ultimate responsibility for removing the directors of the company.

Relevantly, ASIC also has powers to disqualify a director, following which the director ceases to be a director of the company.<sup>55</sup> These powers are particularly relevant in the ACNC Act context as the EM states that the powers of the Commissioner have been modelled on, and are consistent with, those of ASIC.<sup>56</sup> In a number of instances, ASIC is required to apply to the court to disqualify a director, for example where a declaration is made that a director contravened a civil penalty provision,<sup>57</sup> where a person has been involved in 2 or more corporations that have ‘failed’ within the last 7 years,<sup>58</sup> or where the person, or a company that the person was a director of, has contravened the Corporations Act at least twice.<sup>59</sup> In the ACNC Act context, the EM states that the Commissioner’s powers to remove should only be exercised where there are serious contraventions, such as where there has been a persistent failure to meet regulatory obligations,<sup>60</sup> yet in the ASIC context, for multiple contraventions of the Corporations Act, ASIC is still required to apply to the courts for disqualification. There is therefore an

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<sup>53</sup> Corporations Act, section 203C.

<sup>54</sup> Corporations Act, sections 203E and 203D(1).

<sup>55</sup> Corporations Act, section 203B.

<sup>56</sup> Explanatory Memorandum, paragraphs 9.9 and 9.16

<sup>57</sup> Corporations Act, section 206C.

<sup>58</sup> Corporations Act, section 206D.

<sup>59</sup> Corporations Act, section 206E.

<sup>60</sup> Explanatory Memorandum, paragraph 9.30.



additional safeguard in the form of a court process that applies in the ASIC context, that is not adopted by the ACNC Act.

In addition, the breaches that ASIC may apply to the court for are those of the Corporations Act, and not mere 'standards' (such as the ASX Corporate Governance Principles and Recommendations) that may be vague or imprecise in nature. Accordingly, in our opinion, the powers of the Commissioner exceed those of ASIC in this context, even though ASIC is the regulatory body for companies.

However, there are other instances in which ASIC does not have to apply to the court as a precondition to disqualifying a director. Following the giving of a 'show cause'-type notice, and an opportunity for the director to be heard, ASIC may disqualify a director for up to 5 years (but not remove them indefinitely) if the person has been an officer of at least 2 companies at times when the company was wound up due to insolvency or where the company was wound up within 12 months after the person ceased to be a director.<sup>61</sup> Although these powers are similar to those provided to the Commissioner in the ACNC Act context, the grounds upon which ASIC may disqualify a director are much more serious (where the person was involved in a company that became insolvent) than those that the Commissioner may suspend or remove for (that is, a contravention, or likely contravention, of any part of the ACNC Act, governance standards or external conduct standards).

In addition, unlike the Commissioner, ASIC cannot disqualify a person for something that has not yet occurred, as a preventative measure. Accordingly, despite what is propounded by the EM, in our opinion, the powers of the Commissioner are not in fact modelled on those of ASIC as they afford the Commissioner with much wider powers than those vested in ASIC to remove directors. Given that ASIC does not have powers to remove directors for similar instances (even where application to the court is first required) or for a period of more than 5 years (and certainly not indefinitely), and that ultimate power to remove the directors should be vested in the ultimate owners of a company, the members of the company, in our opinion the Commissioner's Suspension and Removal Powers are out of step with and go significantly beyond usual corporations law powers to remove directors.

## **5 Practical implications of the exercise of the Commissioner's powers**

As is discussed in section 6 below, the stated constitutional basis for the removal and suspension powers contained in the ACNC Act are the corporations (section 51(xx) of the Constitution), external affairs (section 51(xxix) of the Constitution) and territories powers (section 122 of the Constitution).

Accordingly, the legislation only applies to corporate trustees or trustees where the trusts are related to the Territories, and would not extend to non-corporate state trustees or to trustees who are natural persons. This results in a dual market being created, where one set of rules applies to the corporate or Territory-related trustees, but other non-corporate trustees would be exempt from these rules. The dual market may be seen to significantly disadvantage corporate or Territory-related trustees in comparison to non-corporate state trustees or trustees who are natural persons, who would both not be subject to the Commissioner's Division 100.

In addition, the enactment of the Removal and Suspension Powers could now increase the levels of uncertainty as it is unclear when and in what circumstances a trustee (or the directors of a corporate trustee) could be removed. The response of a number of industry participants supports this view as one third of organisations consider that they are not well-informed about the changes.<sup>62</sup>

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<sup>61</sup> Corporations Act, section 206F(1).

<sup>62</sup> See article: A Jennings, 'Not-for-profits not so keen on regulator', Lawyers Weekly, 8 January 2013.



This uncertainty may be compounded by the fact that the doctrine of precedent does not apply to the Commissioner's removal or suspension decisions (as would apply if the court was instead to remove the trustee or director), and there is no requirement that the circumstances for removal be made public so that trustees or directors of corporate trustees may be aware of the reasons for the removal of trustees or directors in other instances. In our view, the absence of the protections afforded by the application of the rules of evidence and doctrine of precedent creates the potential for unfairness.

There are also industry concerns among professional corporate trustees about the level of uncertainty generated by the introduction of the new Commissioner's Suspension and Removal Powers, as well as the potential for unfairness in the application of the powers. There may well be a limit on how much uncertainty industry participants are willing to accept and at which they may consider exiting the charitable trust market. This is particularly the case given the powers that have been provided to the Commissioner to remove the directors, and not just the corporate trustee itself, which would act as a significant deterrent to remaining in the market as the effects would extend well beyond the particular capacity as trustee of a registered trust and impact on other parts of their business and trustee appointments. If professional trustees left this market, this would result in a net reduction in the number of trustees in the charitable trust market which in turn would decrease competition and decrease pricing pressure. Any reduction in the number of corporate trustees in the market could also lead to a reduction in service standards and the levels of experience in the market as a whole. This would not be consistent with the general aims of the ACNC Act as referred to in section 3.1 above.

Additionally, as noted above, the commercial impact of removing the directors of a corporate trustee extends beyond the individual trust that the corporate trustee is the trustee of. Where a corporate trustee (including a corporate public trustee) acts as a trustee for multiple trusts (including trusts that are not registered under the ACNC Act), and the Commissioner exercises the power to remove or suspend a director, this would prevent the individual from acting as a director of the corporate trustee in relation to all of the other trusts that the corporate trustee acts as trustee for and would preclude that director from participating in other roles and functions of the corporate trustee. The practical effect of the removal or suspension could therefore extend well beyond the particular capacity as trustee of the registered entity.

As a practical matter, the change of trustee that would occur following the exercise of the Commissioner's power to suspend or remove a trustee will require assets to be legally transferred and possibly registration of the instrument appointing the trustee. Accordingly, the change of trustee will give rise to additional costs in terms of legal documentation, and stamp duty and tax advice should be obtained in relation to the transfer of assets. These additional costs would have to be met from the trust assets.

## **6 Constitutional issues associated with the exercise of the Commissioner's powers to remove or suspend trustees or directors of corporate trustees**

### **6.1 Constitutional basis as stated in the Explanatory Memorandum**

The constitutional basis relied upon by the legislature to support the enactment of the ACNC Act is explained in the EM.

The ACNC Act provides for the registration of entities in order to obtain taxation benefits. Accordingly, a number of the provisions are supported by the taxation power (section 51(ii) of the Constitution).

In relation to the Commissioner's Removal and Suspension Powers, there three key constitutional bases are relied upon by the Commonwealth Parliament:

- 1 the corporations power (section 51(xx) of the Constitution);
- 2 the territories power (section 122 of the Constitution); and

3 the external affairs power (section 51(xxix) of the Constitution).<sup>63</sup>

The removal and suspension powers in relation to breach (or breach that is more likely than not) of the ACNC Act and governance standards are limited in application to the responsible entities of ‘federally regulated entities’,<sup>64</sup> which, as noted in section 2.3 above, are either constitutional corporations (defined as corporations pursuant to section 51(xx) of the Constitution or body corporates incorporated in Territories) or entities that are somehow linked to the Territories. These limitations are aimed at ensuring that Division 100 is supported by the corporations and territories powers.<sup>65</sup>

In relation to the removal or suspension for the contravention (or contravention that is more likely than not) of the external conduct standards, as these relate to matters external to, or that are closely related to or have a significant impact on matters external to, Australia, the EM states that the external affairs power in section 51(xxix) of the Constitution is used to support the removal and suspension powers of the Commissioner.<sup>66</sup>

## 6.2 Constitutional issues

### (a) Constitutional powers to support the enactment of the Commissioner’s removal and suspension powers

#### (1) Corporations power

For the corporations power to support these powers of the Commissioner, the application of the provisions would have to be limited to constitutional corporations (as opposed to all corporations). Otherwise, the ACNC Act is amenable to being read down by the High Court to apply only to constitutional corporations. As noted above, the provisions with regard to contraventions of the ACNC Act or governance standards are limited to section 51(xx) constitutional corporations (and body corporates incorporated in territories, which is instead purported to be supported by the territories power).

Once it is established that the legislation is limited in application in this way, an issue arises as to whether the legislation and the exercise of the Commissioner’s Suspension and Removal Powers are of the nature that may be supported by the corporations power. The two alternative views with regard to the extent of the corporations power are as follows:

- Narrow view: Commonwealth laws dealing with “constitutional corporations” (by which we mean foreign corporations and trading or financial corporations formed within the limits of the Commonwealth) may only regulate aspects or activities of a corporation that are connected to the activities that identify it as either a constitutional corporation. This narrow view was favoured by the majority of the High Court in *Commonwealth v Tasmania* (1983) 158 CLR 1 (**Tasmanian Dam Case**); or
- Broad view: The power is “plenary”, that is, once it has been established that the law applies to constitutional corporations, then any aspect or activity of such a corporation may be regulated. This broad view was favoured by the majority of the High Court in *New South Wales v Commonwealth* (2006) 231 ALR 1.

The High Court has revisited this issue on a number of occasions and there has been some uncertainty as to which view is the correct view. If there was a constitutional challenge to the exercise of the Commissioner’s Suspension and Removal Powers in

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<sup>63</sup> Explanatory Memorandum, paragraphs 2.7-2.14.

<sup>64</sup> ACNC Act, subdivisions 100-5(1)(a)-(b).

<sup>65</sup> Explanatory Memorandum, paragraphs 2.7-2.9.

<sup>66</sup> Explanatory Memorandum, paragraph 2.13.



respect of a constitutional corporation and the High Court was to adopt the view of the majority in the Tasmanian Dam Case, the exercise of the Suspension and Removal Powers may not be supported by section 51(xx) of the Constitution in the particular context.

## **(2) Territories power**

The remaining entities that are referred to in the definition of ‘federally regulated entity’ are related to the territories power. Section 122 of the Constitution provides that the Commonwealth Parliament to “make laws for the government of any territory surrendered by any State to and accepted by the Commonwealth, or of any territory placed by the Queen under the authority of and accepted by the Commonwealth, or otherwise acquired by the Commonwealth...”

The extent of this power was considered by Stephen J in *Attorney-General (WA) v Australian National Airlines Commission* (1976) 138 CLR 492 and Mason J in *Berwick Ltd v Gray, Deputy Commissioner of Taxation* (1976) 133 CLR 603 to be a plenary power. In the case of a plenary power all that needs to be shown to support an exercise of this power is that there is a sufficient nexus or connection between the law and the relevant Territory.

As this power is a plenary power, to the extent that the Commissioner’s removal and suspension powers are limited in application to Territories (by virtue of the definition of ‘federally regulated entity’), regulating body corporates, corporations and entities that are Territory-based (such as the Public Trustees in the Territories) is likely to be within the powers of Parliament.

## **(3) External affairs power**

On the other hand, in relation to the contraventions of the external conduct standards, the exercise of the Suspension and Removal Powers is not limited to federally regulated entities, but instead the Commissioner may remove the responsible entity of any registered entity (including non-corporate trustees that are not Territory-based). As noted above, these standards must only deal with matters external to Australia or matters not external to Australia but that are closely related to, or have or will have a significant impact on, entities, things or matters external to Australia.<sup>67</sup> Based on either the majority or the dissenting judgments in *Polyukovich v Commonwealth* (1991) 172 CLR 501, the apparent statements in *Horta v Commonwealth* (1994) 181 CLR 183 or the joint majority judgment in *Victoria v Commonwealth* (1996) 187 CLR 416, it is likely that the relevant provisions of the ACNC Act have been validly enacted since there is both a link to geographical externality (funds sent outside Australia or activities engaged in outside Australia) and a nexus to Australia (that it is related to Australian entities registered under the ACNC Act).

### **(b) Exercise of judicial power by the executive**

The EM provides that “[a]ffording the ACNC Commissioner the power to suspend or remove trustees, in appropriate circumstances, moves this power from being a judicial function to a regulatory function.”<sup>68</sup> However, the case law does not definitively provide that the power takes its character from the person in whom it is vested in. Accordingly, there is the potential for the Commissioner’s Suspension and Removal Powers to be characterised as “judicial powers”, which would be a breach of the separation of powers provided in the Constitution. This breach could occur even if the relevant provisions of the ACNC Act are supported by a power referred to section 6.2(a) above.

There is no precise definition about what constitutes a ‘judicial power’. At a basic level, Griffith CJ started in *Huddart, Parker & Co Pty Ltd v Moorehead* (1909) 8 CLR 330 that

<sup>67</sup> ACNC Act, subdivision 50-10(3).

<sup>68</sup> Explanatory Memorandum, paragraph 9.211.



'judicial powers' "mean the power which every sovereign authority must of necessity have to decide controversies between its subjects, or between itself and its subjects, whether the rights relate to life, liberty or property. The exercise of this power does not begin until some tribunal which has power to give a binding and authoritative decision (whether subject to appeal or not) is called upon to take action." Justice Kitto further provided in *R v Trade Practices Tribunal; Ex parte Tasmanian Breweries Pty Ltd* (1970) 123 CLR 361 that "...a judicial power involves, as a general rule, a decision settling for the future, as between defined persons or classes of persons, a question as to the existence of a right or obligation, so that an exercise of the power creates a new charter by reference to which that question is in future to be decided as between those persons or classes of persons... the process to be followed must generally be an inquiry concerning the law as it is and the facts as they are, followed by an application of the law as determined to the facts as determined; and the end to be reached must be an act which, so long as it stands, entitles and obliges the persons between whom it intervenes, to observance of the rights and obligations that the application of law to facts has shown to exist."

Essentially, there are a number of factors which have to be considered in determining whether the power is judicial or non-judicial in nature. Accordingly, in our view, the exercise of Suspension and Removal Powers could lead to a constitutional issue regarding the validity of these powers.

**(c) Compulsory acquisition of property**

Division 185-10 of the ACNC Act provides a procedure that applies where the ACNC Bill leads to the acquisition of property other than on just terms. As "acquisition of property" and "just terms" are defined in subdivision 185-10(3) of the ACNC Act as having the meaning from paragraph section 51(xxxi) in the Constitution, the provisions are quite circular.

Unlike the Tasmanian Dam Case noted above, subdivision 185-10(1) does provide for the liability of the Commonwealth to pay a reasonable amount of compensation to a person whose property has been acquired within the meaning of the Constitution. Accordingly, these procedures would likely be considered by the High Court to be adequate.

The real constitutional issue will arise if and when the property is in fact acquired on the removal of a trustee and the operation of Division 185 is activated. A dispute may arise then as to whether what is actually provided is on 'just terms' within the meaning of section 51(xxxi) of the Constitution.

Yours sincerely

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