

GRAHAM WHEELER BComm. LLB. Dip Ed.
SOLICITOR
18 Gregory Street, Ermington NSW 2115

Tel: (02) 9638-5805
Fax: (02) 9638-6710
Email: g.wheeler@optusnet.com.au

31st March 2008

Associations Incorporation Bill 2008
Policy & Strategy Division
NSW Office of Fair Trading
PO Box 972
PARRAMATTA NSW 2124

Dear Sir/Madame,

REVIEW OF ASSOCIATIONS INCORPORATIONS ACT

Thank you for your letter of 26 February 2008 providing a copy of the "Summary of Major Changes Contained in the Associations Incorporation Bill 2008". As a lawyer who advises many incorporated associations and has written a number of publications related to the *Associations Incorporation Act 1984* (the Act), I am pleased to have the opportunity to make the following submission.

In making this submission, I acknowledge that a number of the proposed changes represent positive improvements to the regime e.g. non-compulsory common seal, by-laws no longer defined as part of the rules. However, the comments that follow are aimed at highlighting aspects of the Bill that I believe require further consideration.

1. REGULATION OF LARGE TRADING ASSOCIATIONS

It is surprising that the "Summary of Major Changes Contained in the Associations Incorporation Bill 2008" does not mention the removal of the Minister's power under section 56(2) to direct an existing association to become incorporated under the *Corporations Act* or the *Co-operatives Act*. The Summary also makes no mention of the fact that the restriction on trading by incorporated associations has been removed (see sections 7(2)(a) & 66 of the Act).

The removal of the Minister's power marks an extremely significant change in the philosophy of the Associations legislation. The decision to retain and regulate "large associations" means that the *Associations Incorporation Act* can no longer focus on regulating small to medium sized associations. The removal of the restriction on trading magnifies the effect of this change by enabling a totally different type of association to exist under the Act.

This proposed new direction means that the Office of Fair Trading will need to address issues relevant to larger "commercial style" organisations. The Bill marks the start of this process by introducing an audit requirement for "large associations"

and criminal sanctions for committee members of all types of association (sections 29-33).

In future years, the demands of regulating large trading associations will most likely lead to a growth in the size and complexity of the *Associations Incorporation Act*. No doubt many of the provisions of the *Corporations Act* will gradually find their way into the *Associations Incorporation Act*.

When the *Associations Incorporation Act* was enacted, parliament's aim was to provide **a cheap and simple alternative to incorporation as a company limited by guarantee**. To quote from a 1994 NSW Consumer Affairs "Regulatory Impact Statement".

"The *Associations Incorporation Act* was introduced in 1985 to provide a relatively cheap and simple means of providing corporate status as an alternative to incorporation as a company under the then Companies (NSW) Code. The legislation is aimed at non-commercial organisations, particularly community service and sporting clubs with the aim being to facilitate their operation rather than to control their behaviour."

I therefore question the desirability of effectively ending a legislative regime that was established to help small to medium sized associations and starting to duplicate the system for larger trading associations under the *Corporations Act*.

Should the decision to refashion the nature of the Act proceed, I note that the amount of \$200,000 was the figure suggested in the "Review of the Associations Incorporation Act 1984. Consultation Paper" dated April 2003. As it is nearly 5 years since that paper was published it seems reasonable that an amount of at least \$225,000 should be initially prescribed to take into account the effect of inflation at a rate of at least 2.5% pa.

Conclusion 1

The decision to use the Act to regulate large trading associations will change the Act's focus away from its original purpose. Further consideration should be given to the wisdom of creating a system of regulation and enforcement by OFT that is likely to end up effectively duplicating the system operated under the *Corporations Act* by ASIC.

2. STATUTORY DUTIES OF MANAGEMENT COMMITTEE

Sections 29 – 33 of the Bill impose a number of additional criminal sanctions on committee members that do not exist under the 1984 Act. To legislate in this area suggests that aggrieved parties would be able to lodge complaints, have them investigated and, if necessary, prosecuted by the Director-General.

There are a number of matter in relation to these proposed new provisions which I see as being problematic.

No actual loss or damage required to establish offences

None of the offences created under sections 29-33 require that the proscribed action must result in any actual loss or damage being incurred by the association or any other party.

Taking the section 33 offence of “Negligence” as an example.

“A committee member ... who ... fails to exercise the degree of care and diligence that a reasonable person would exercise .. is guilty of an offence.”

Compare this with an action in the tort of negligence where, to be successful, the claimant must prove both the breach of a duty of care and actual, proximate harm resulting from that breach.

Given the voluntary nature of community organisations, it is not uncommon to find committee members who fail to regularly attend meetings or are slow to carry out tasks that have been assigned to them. If actual loss or damage results from such behaviour the party who suffers the loss can recover by an action in negligence.

If there is no actual loss or damage, a typical response to this type of behaviour is removal from the committee, resignation or a failure to be re-elected. The option of reporting the person to the OFT and subjecting them to a financial penalty seems inappropriate and out of touch with community values.

A similar argument applies to the offences in sections 29-32 of failure to disclose, dishonesty and improper use of information. In each situation there are existing remedies for serious cases (such as prosecution under the *Crimes Act*). In such circumstances, it is difficult to see any benefit in adding an extra level of criminalisation to regulate the behaviour of community volunteers – especially if their behaviour does not result in any actual loss or harm.

It also worth noting that in the event that loss or harm does occur, the offences do not provide any additional help to the aggrieved party.

Increased involvement of the Director-General in internal disputes

The philosophy of the 1984 Act was to encourage associations to resolve internal disputes by techniques such as mediation. In my experience, the Office of Fair Trading (OFT) has tried to avoid being drawn into the role of investigating and attempting to resolve disputes that often arise between different factions of an association. The result was usually that such disputes played themselves out via internal power struggles within the association. On occasions where either the stakes or passions were particularly high, lawyers were engaged and matters that involved a breach of the law or constitution were either formally settled or litigated.

These types of internal disputes are usually focused on gaining control of the association and typically begin with claims that current committee members have done something like – acted despite a conflict of interests, made improper use of information or position, been dishonest, or failed to exercise reasonable care.

If these new offences are introduced, parties in dispute will quickly realise that by alleging a breach of one of these sections they will be able to bring pressure to bear on the committee via the OFT. Given that the Bill makes these types of behaviour a criminal offence, the OFT will need to investigate the veracity of a claim before determining whether or not to commence its own enforcement action (or notify the police). If enforcement action is commenced against committee members, it seems likely that the committee will then draw on the association’s funds to obtain legal advice and representation if the matter proceeds to a hearing. The end result for

small to mid-sized associations may well be the dissipation of the association's funds and possible winding-up or the cancellation of its incorporation.

Size of the penalties

The sections impose maximum penalties of between 60 to 240 penalty units and in some cases up to 2 years imprisonment. These penalties seem excessive when compared to the penalty for fraudulent conduct under the 1984 Act (s38) and this Bill (s70) i.e. 100 penalty units and imprisonment for 1 year.

People who accept a position on the committee of an association are usually motivated by a sense of public spirit and often do so with little previous experience or training. It is my experience that there is an increasing sense of fear about the legal obligations they are taking on and the possibility of personal liability. The introduction of the type of penalties proposed is likely to act as a further deterrent to people who may otherwise be inclined to serve on the committee of a community organisation.

Conclusion 2

The criminal provisions in sections 29 – 33 should be removed. There are other laws (e.g. Crimes Act) which establish penalties for criminal activity.

If the aim of sections 29 – 33 is to promote ethical standards among committee members and/or to address difficulties in dealing with committee members who breach their duty to members a less punitive approach seems more desirable.

A more constructive approach would be to structure the rules of associations to address the problems. For example, obligations similar to those in sections 29-33 could be deemed to be included in the rules of each association. This could then be used as basis for removing the offending committee member(s) from office. It would also give members a contractual right to sue for any loss or damage that flowed from a breach of such rules (see section 25(1) of the Bill).

3. TERMINOLOGY.

Secretary/Public Officer

I expect that the proposed change of terminology from to “public officer” to “secretary” and method of appointment may create a significant amount of confusion.

a) Two secretaries

It is my experience that many associations have rules which specifically provide for an elected secretary and an appointed public officer. Under the proposed changes a significant number of such associations will find themselves with two individuals with the title of “secretary” but with different modes of appointment and different responsibilities. I expect that many of these individuals will need guidance as to how to resolve this situation and whether the new Act requires both of them to notify the Director General of their name and residential address.

b) Replacement by election

Section 23 of the 1984 Act provides that a vacancy in the position of public officer must be filled by the committee. However, the Bill allows for the possibility that a replacement secretary may be either appointed by the committee or elected by members of the association. This is at variance with the requirements of the *Corporations Act 2001* (s204D) which requires the company secretary to be appointed by the directors.

Associations with rules that do not contain provisions for the appointment of a public officer, but do provide for a secretary and require that a casual vacancy in the position of secretary must be filled at a general meeting may find the proposed change unreasonably onerous. In such situations there will be pressures of both time and cost associated with electing a new secretary within 28 days after the vacancy arises. The possibility of the general meeting being unable to elect a new secretary (e.g., no valid nominations or a lack of quorum) must also be considered as section 35(3) of the Bill provides for a penalty of 2 penalty units.

If the proposed changes are adopted, consideration will need to be given on how to deal with both of the above situations. One option would be for the Bill to contain transitional provisions that deem certain changes into the constitutions of all existing associations. However, I suspect that it would be difficult to draft changes in a manner that would be applicable to all associations.

Alternatively, associations could be required to amend their constitutions to overcome any transitional problems. However, this would involve incurring the costs associated with calling a general meeting, possibly obtaining legal advice and paying registration fees. It also relies on associations having the knowledge, initiative and resources to take such action.

Conclusion 3

The transitional problems associated with the change of title from “public officer” to “secretary” and also allowing the position to be filled by election, seem to outweigh any perceived advantage in attempting to combine these positions.

Rules/Constitution

Although I support the revised definition of this concept, the proposed change of terminology from “Rules” to “Constitution” seems contrary to current usage of those terms. In my experience, the document that most associations refer to as their constitution includes both their objects and rules. The *Corporations Act 2001* (s125) also adopts this approach by providing that a company’s constitution may contain the company’s objects.

Conclusion 4

The new definition of the term “constitution” contained in the Bill should be retained but the term “rules” used instead of the term constitution.

The term “constitution” could be included providing that it is defined to include both the objects and rules of an association.

4. SECRETARY

Section 34(6) of the Bill provides that “Any act done by a former secretary purporting to act as secretary is valid, in relation to a person dealing with the association in good faith and not knowing that the former secretary is no longer the secretary, as if the former secretary were still the secretary.”

This seems to be an unreasonable extension of the protections offered to people dealing with associations by section 23 of the Bill. The situation of a third party dealing in good faith with a former secretary could be compared with a pre-incorporation contract. Under section 33 of the 1984 Act, a person who on behalf of the association enters into a pre-incorporation contract is personally liable for the contract unless it is ratified by the association.

Conclusion 5

Section 34(6) of the Bill should be deleted or amended to provide that the former secretary is personally liable for his/her acts.

5. GENERAL ADMINISTRATION

General Meetings

I note that page 3 of the OFT Summary incorrectly states that the “Current provisions allow associations to .. hold their annual general meeting within 5 months of the end of their financial year ..”. This error is mirrored in section 37(2)(a) of the Bill which reduces the period in which an annual general meeting must be held from 6 to 5 months after the end of the association’s financial year.

Many associations have included this 6 month period into their rules [e.g. see Model rule 23(1)] and established an annual routine based on this period. Given the acknowledged difficulty in getting some associations to lodge their annual returns in time, the shortening of this period would seem to exacerbate an existing problem.

Conclusion 6

The period of time in which to hold the annual general meeting should remain unchanged at “within 6 months after the close of the association’s financial year.” See section 37(2)(a) of the Bill.

Postal ballots

Section 38(1) of the Bill has the effect of deeming the right to a postal ballot into the rules of all existing associations. There seems no reason for doing this as associations have always had the option to include a provision for postal ballots in their rules if this was what they wanted - indeed some associations already have such provisions.

For small associations with limited resources this proposed change may well be contrary to their wishes and could create an unexpected and unreasonable financial burden if required by a small disaffected group of members to conduct a postal ballot.

Conclusion 7

Postal ballots should be optional and require an association to “opt in” rather than have to “opt out”.

Special resolutions

Section 40 of the Bill does not specify the period of notice required for a special resolution to be passed. Section 5 of the 1984 Act and the *Corporations Act* both specify that at least 21 days' written notice of a proposed special resolution must be given to members.

Conclusion 8

The Bill should provide that a period of at least 21 days' written notice of a proposed special resolution should be given to members.

7. CANCELLATION OF INCORPORATION

Voluntary Cancellation

The provisions dealing with distribution of surplus property used in section 66 of the Bill (winding up) and section 55B of the 1984 Act (voluntary cancellation) are not duplicated in section 76 of the Bill.

Section 76 refers to distribution of an "association's assets" rather than "surplus property". It also appears to prohibit distribution to a former member even if the member "is an association .. whose constitution .. prohibits the distribution of property to its members."

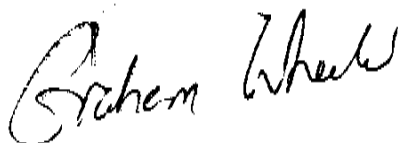
An association will need to pay all outstanding debts and liabilities prior to cancellation of incorporation. Therefore, it is more accurate to refer to the distribution of its surplus property than its assets, as some of the assets may have charges over them or may need to be liquidated in order to settle outstanding debts.

There will be many associations that have members who are also charitable associations with similar objectives. There seems no logical reason why, on cancellation, such associations should not be allowed to distribute surplus property to such members.

Conclusion 9

The wording used in section 66 of the Bill should be duplicated in section 76.

Yours sincerely,

A handwritten signature in black ink that reads "Graham Wheeler". The signature is written in a cursive, slightly slanted style.

Graham Wheeler