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Incorporated Associations

Liability of Board/Committee Members

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INCORPORATED ASSOCIATIONS – LIABILITY OF BOARD/COMMITTEE MEMBERS

1. Introduction

1.1 In theory, people in decision-making roles within incorporated associations face a fearsome array of potential liabilities. In practice, cases where these people have been held personally liable are rare.

1.2 The purpose of this paper is to tell people who serve on the boards and committees of incorporated associations enough about the theoretical liabilities to keep them out of trouble, without scaring them so much that they won't take on the jobs. Incorporated associations play a useful function in the community and it's hard enough for them to get people to take leadership positions as it is.

1.3 Let's sort out the terminology first. Incorporated associations call their governing bodies by a variety of names, of which "board" and "committee" are the most common. In this paper I will follow the lead of the *Associations Incorporation Act 1987* (WA) in using the generic term "committee" to refer to the governing body of an incorporated association, by whatever term it may be called in the association's constitution.

1.4 There are 6 broad sources of potential liability for committee members:

(a) The *Associations Incorporation Act*.

(b) The general law, which imposes fiduciary and other obligations.

(c) Insolvency laws – the *Corporations Act 2001* (Cth) and the *Income Tax Assessment Act 1936* (Cth).

(d) Activity-specific legislation such as the *Occupational Safety and Health Act 1984(WA)*.

(e) Acts of general application like the *Fair Trading Act 1987* (WA) and *Corporations Act*, which can impose accessorial liability on decision-makers for things done by the incorporated association.

(f) The *Criminal Code 1913* (WA), which imposes liability for various kinds of dishonest behaviour.

1.5 Theoretically, there is a seventh source: the association's constitution or rules. The constitution can impose additional liability on committee members, but this is not required by the Act. In practice it is so rare for a constitution to impose significant additional liabilities on committee members that I don't propose to spend time talking about it.

1.6 I have referred to the *Corporations Act* as a source of potential liability in the insolvency area only. The *Corporations Act* does not apply to incorporated associations generally. To see why, you must follow a tortuous logical path:

(a) Section 3A of the *Associations Incorporation Act* says incorporated associations are excluded matters for the purposes of section 5F of the *Corporations Act*.

(b) By force of section 5F(2)(a) of the *Corporations Act*, none of the provisions of the Corporations legislation apply to incorporated associations.

(c) Section 31(3) of the *Associations Incorporation Act* then declares the winding up (other than voluntary winding up)[1] of an incorporated association by the Supreme Court to be an "applied Corporations legislation matter" for the purposes of Part 3 of the *Corporations (Ancillary Provisions) Act 2001* (WA) in relation to Part 5.7 of the *Corporations Act*.

(d) By force of section 15(1)(c) of the *Corporations (Ancillary Provisions) Act*, Part 5.7 of the *Corporations Act* applies in relation to the (non-voluntary) winding up of an incorporated association by the Supreme Court as if it was a law of the State.

As to whether the steps in (c) and (d) are effective to reapply the insolvency provisions, see section 4 below. It is at least clear that the steps in (a) and (b) are effective to take the affairs of WA incorporated associations outside the reach of the Commonwealth *Corporations Act*.

2. The Associations Incorporation Act

2.1 Don't look for conventional, *Corporations Act*-style statements of directors' and officers' duties in the *Associations Incorporation Act*. You won't find them. An amendment proposal in 1998 recommended that duties of officers and employees of associations should be set out in the Act,[2] but this has not happened.

2.2 There are some rather random statements in the Act relating to the duties and responsibilities of committee members:

- Section 21(1) requires committee members to disclose their interests in contracts or proposed contracts.
- Section 22(1) requires committee members who are interested in contracts to exclude themselves from discussion and voting on the contracts.
- Section 42 requires committee members to take all reasonable steps to secure compliance by the association with its obligations under the Act.
- Section 43 imposes liability on people who knowingly make or authorise false or misleading statements or omissions in documents lodged with the Commissioner or submitted to members.

In each case, contravention is an offence carrying a penalty of $500.

2.3 Committee members should certainly know about these liabilities. In fact, to comply with section 42, they need to know what all the obligations of the association under the Act are. But to get the big picture view on their personal liability exposure, they will need to go well beyond the express words of the Act.

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[1] There is also a provision in section 30(4) of the Act for Parts 5.4 to 5.8 of the *Corporations Act* to be applied by regulation to voluntary winding up of incorporated associations. Most of the provisions of Parts 5.5 and 5.6 have been applied by regulation 6 of the *Associations Incorporation Regulations 1988*. Voluntary winding up is not dealt with in this paper as it will not generally have liability consequences for committee members.

[2] WA Ministry of Fair Trading (now Department of Consumer and Employment Protection), *The Associations Incorporation Act 1987 – Proposals for Reform*, March 1998, Proposal 12. The recommendation was that the duties should equate with the duties of officers and employees of other bodies corporate.

3. **General law obligations**

3.1 Although there is no authority on the point, commentators agree that committee members of incorporated associations probably owe fiduciary duties to the associations, which are the same as or similar to the duties owed by directors to their companies.[3]

3.2 Every commentator seems to have a slightly different way of stating directors' general law duties. In *Ford's Principles of Corporations Law*,[4] the duties are stated as follows:

(a) duty of loyalty, subdivided into duties:

(i) to act in good faith in the best interests of the body corporate;

(ii) to act for proper corporate purposes;

(iii) to give adequate consideration to matters for decision and to keep discretions unfettered; and

(iv) to avoid conflicts of interest;

and

(b) duty of care (arising both in equity and at common law).

3.3 There is a lot of law on the application of these duties, and their modern statutory parallels, to company directors. I do not intend to go over all of that ground in this paper. I will focus on 4 questions:

(a) Why are there no cases on the general law duties of committee members?

(b) Are there differences between companies and incorporated associations, which should lead courts to impose different standards of fiduciary duty on decision-makers?

(c) Will the extensive and sophisticated judicial analysis of the **statutory** duties of company directors influence the courts' approach to the general law duties of committee members?

(d) Are committee members of associations (theoretically at least) in a worse position than company directors, because of the absence of statutory relief provisions such as section 1318 of the *Corporations Act*?

Why haven't there been any cases?

3.4 For litigation to arise in any area, 2 things are needed:

(a) The area must involve some activity which has the capacity to result in loss.

(b) The loss must be suffered by someone with the will and the means to bring legal action.

3.5 This combination seldom if ever arises from the activities of incorporated associations. In many cases, the activities of the association are very limited in scope and do not have much commercial

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[3] See for example K L Fletcher, *The Law Relating to Non-Profit Associations in Australia and New Zealand* (1986) 289; A S Seivers, "Voluntary Associations" in *Halsbury's Laws of Australia* 435-205; R A Fisher, "Duties of company directors and committee members of incorporated associations: Have the paths divided?" (2001) 13 *Australian Journal of Corporate Law* 143, 144-5.

[4] Looseleaf service, para 8.010.

content. In other cases (for example, schools), the association may have a substantial turnover and may be involved in a wide range of activities which interact with the commercial world. In these cases, there is obviously potential for things to go wrong and for loss to be suffered – although for the most part, large incorporated associations tend to be conservatively managed. Even when something does go wrong, a number of factors make it unlikely that any action for breach of fiduciary duty will be brought against committee members:

(a) Members view the affairs of an incorporated association differently from those of a for-profit company, because they have not invested their own money with an expectation of gain. Rather, their participation in the organisation is driven by shared values.

(b) The proper plaintiff in an action for breach of duty is the body corporate. Only in the case of a very major financial loss is an association likely to contemplate suing its own committee members – and even then it may not have the financial resources to do it. Theoretically, a common law representative action would probably be available, but this would require a very determined and aggrieved member with money to spare (or a close relation in legal practice, without much else to do).

(c) The likelihood of an action by the association is even lower when the committee members are still serving on the committee.

(d) Many incorporated associations have constitutions which contain exemptions from liability and indemnities, so that the association could not sue its committee members even if it wanted to. The *Associations Incorporation Act* contains no equivalent of section 199A of the *Corporations Act*. This subject is discussed in section 8 below.

3.6 An additional factor which may be relevant is that a number of the larger incorporated associations in Western Australia are not really "membership" organisations at all. For example, a number of schools affiliated with churches have their members appointed by the governing body of the church. In these cases it is likely that any decision on enforcing the duties of committee members where something goes wrong will be influenced by the policy and values of the appointing body.

3.7 Another factor is also relevant to the amount of case law in an area: the amount of social risk perceived to arise from the area, which flows through into the level and funding of regulatory activity. Probably because the activities of incorporated associations are perceived to involve less risk to society than those of for-profit corporations, the level of regulatory supervision over the activities of incorporated associations by State authorities (such as WA's Department of Consumer and Employment Protection) is much lower than the level of regulatory supervision over corporations by ASIC.

3.8 The upshot of all this is that as long as an association remains solvent, the likelihood of an action against committee members for breach of duty is low. This explains why there are no cases in the area.

3.9 In the insolvency situation this may change – especially where the association has substantial liabilities to creditors. The liquidator (or possibly a creditor) could well seek to recover the shortfall from committee members. However, the action would probably be taken under the insolvent trading provisions of the *Corporations Act* as applied to incorporated associations – see paragraph 1.6 above. The potential liability of committee members for insolvent trading is considered in section 4 below.

3.10 A spectacular example of insolvent trading liability for members of the governing body of an incorporated non-profit organisation was provided by *Commonwealth Bank v Friedrich*.[5] This case involved the National Safety Council, a not-for-profit organisation incorporated as a company limited by guarantee under the former *Companies (Victoria) Code*. This organisation grew very large and borrowed huge sums from banks, but it became the vehicle for an elaborate fraud

[5] (1991) 9 ACLC 946; 5 ACSR 115

perpetrated by the chief executive John Friedrich. After the fraud was exposed and the company collapsed, the Commonwealth Bank brought an insolvent trading action against the directors. Friedrich disappeared and ultimately committed suicide. Most other directors settled, but the honorary chairman Mr Max Eise fought the case. He was ordered to pay $97 million to the Commonwealth Bank. That is a liability big enough to get anyone's attention.

3.11 Two inferences may be drawn from the National Safety Council case: the risk of liability increases exponentially in an insolvency situation, and the most likely cause of insolvency for an incorporated association is the hubris, incompetence or fraud of the person in charge of management.

Differences in duties between incorporated associations and companies?

3.12 The decision of the NSW Court of Appeal in *Daniels v Anderson* is one of the leading Australian authorities on the duties of company directors. The joint judgment of Clarke and Sheller JJ A contains a detailed review of directors' common law duties, leading to the conclusion that company directors now owe a duty of care in negligence as well as a fiduciary duty of care. The judgment contains the following passage:

> A person who accepts the office of director of a particular company undertakes the responsibility of ensuring that he or she understands the nature of the duty a director is called upon to perform. That duty will vary according to the size and business of the particular company and the experience or skills that the director held himself or herself out to have in support of appointment to the office.[6]

3.13 An incorporated association is similar to a company in some ways, but quite different in others. The principal difference is that the incorporated association does not exist for the purpose of making a profit.[7] It follows that members are not trusting the committee members with the stewardship of significant amounts of their money, with a brief to employ it gainfully. The committee member still occupies a position of responsibility and trust, which can involve stewardship of significant amounts of money arising from membership contributions or fees and fund-raising activities. However, what the organisation and society generally is entitled to expect from the occupants of these positions must be moderated by several factors:

(a) The positions are usually voluntary.

(b) The work is usually carried out on a part-time basis.

(c) It is in the interests of the community that organisations should exist for the non-profit purposes listed in section 4 of the Act, and they cannot exist without committee members.

3.14 It is evident, however, that these factors will not relieve committee members from liability completely, as the decision in *Commonwealth Bank v Friedrich*[8] shows. Although the National Safety Council was a company limited by guarantee, all of the factors listed in paragraph 3.13 above still applied to the directors. These factors were specifically considered by Tadgell J, in considering whether to relieve Mr Eise from liability under section 535 of the *Companies (Victoria) Code* (now section 1324 of the *Corporations Act*). He recognised that standards of duty could vary according to circumstances:

> There is nothing in the Code to suggest that the standard to be expected of a part-time non-executive director of a company not for profit is different from the standard expected of any other director of a profit-making company. … Notwithstanding that, conduct that will be

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[6] (1995) 16 ACSR 607, 668; (1995) 37 NSWLR 438, 505; (1995) 118 FLR 248.

[7] *Associations Incorporation Act*, section 4.

[8] Note 5 above.

> held to involve a departure from the required standard of reasonableness will vary infinitely from case to case according to the circumstances.[9]

3.15 His Honour then listed the exonerating factors that worked in Mr Eise's favour:

> … I should think it legitimate to take into account Mr Eise's position as a non-executive and part-time director, that he was unpaid, that … he was motivated by a desire to involve himself in a useful community service, and that he did so involve himself. I should think it right that the courts should use the jurisdiction conferred by section 535 in an appropriate case to provide a flexible form of relief to voluntary, non-executive directors of companies not for profit. It is in the public interest that, while directors should be held accountable for their conduct, able people should not be deterred from offering their voluntary services for want of appropriate protection. It would also be right … to take account of the fact that Eise was duped by Friedrich's fraud.[10]

3.16 And yet, after all this, his Honour concluded:

> If, in the face of Mr Eise's conduct, I were to apply section 535 in his favour, I should do a serious disservice to the administration of the Code and to the commercial community.[11]

What went wrong? What was so bad about what Mr Eise did?

3.17 The answer lies in a statement Mr Eise had signed about the National Safety Council's annual accounts. By that statement Mr Eise represented that the directors had considered and approved the accounts, when they had not done so. To make it worse, he had not even read the accounts when he signed the statement, because they were not ready. Under questioning from a member at the AGM, the directors (including Mr Eise) stuck to their statement that they had read and approved the accounts. Tadgell J said:

> If Mr Eise's conduct at and immediately before the annual general meeting was not dishonest – involving some moral turpitude - it was surely conduct of the utmost folly … . It was conduct that led in an important way to the company's reaching, and remaining in, the state of financial disarray in which it was when it began to make the relevant borrowings … .[12]

3.18 I think that if courts are called upon to formulate fiduciary duties for committee members of incorporated associations, they will be prepared to take into account the special circumstances which differentiate those organisations from companies, and which differentiate their committee members from company directors. This is likely to result in a lower standard of duty than for company directors – a standard that aligns with general community standards of sensible and responsible behaviour, rather than commercial competence or expertise. However, if the case involves dishonesty or "conduct of the utmost folly", committee members are likely to find themselves liable, even at this lower standard.

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[9] (1991) 9 ACLC 946, 1011.

[10] Ibid, 1012.

[11] Ibid.

[12] Ibid.

Will cases on the statutory duties of company directors feed through into the fiduciary duties of committee members?

3.19 Robert Arnold Fisher wrote a thoughtful article on this question in 2001,[13] and I commend that to those of you who wish to pursue the subject. His conclusions were broadly to the following effect:

(a) If courts had to formulate duties for committee members of incorporated associations, they would very likely have regard to the extensive judicial analysis of the statutory duties of company directors.

(b) However, a barrier to applying this analysis by analogy is that the Corporations legislation is designed to cover a different type of entity from incorporated associations.

(c) Duties of those involved in governance of incorporated associations remained unclear, leaving these people in a situation of uncertainty about what was expected of them.

3.20 I agree with these views. I have no doubt that if the issue comes up before a court, the court will refer to the cases on statutory and common law duties of directors. I think the court will find the decision of the NSW Court of Appeal in *Daniels v Anderson*[14] particularly helpful, since that case analyses the history of the common law duty of care as it has developed alongside the corresponding statutory duty.

3.21 My personal view is that in setting duty standards for committee members of incorporated associations, courts would start by going back to early statements of the common law standard for company directors, as expressed in cases like *Re City Equitable Fire Insurance Co*.[15] As pointed out in *Daniels v Anderson*, these tend to be based on concepts of gross negligence determined by subjective tests.[16] I doubt, however, whether courts would now be prepared to apply standards which have been so thoroughly discredited in the context of statutory directors' duties. I think it is more likely that courts will pick up the spectrum of standards now applied to directors of companies of different shapes and sizes, and choose a standard towards the lower end of the scale.

3.22 Another way of arriving at the same result would be to fall back on the *Donoghue v Stevenson* negligence standard referred to in *Daniels v Anderson*, which depends on a "general public sentiment of wrongdoing for which the offender must pay".[17] This has the advantage of adopting the same approach which underlies modern judicial analysis of directors' duties: aligning the duties with community expectations. It permits the court to recognise the fact that community expectations of committee members of incorporated associations are lower than community expectations of company directors.

3.23 However, as pointed out above there are limits to the leniency of this approach. The community expects people in responsible positions to act honestly, to avoid "conduct of the utmost folly", and not to neglect their duties completely. In other words, they must make an honest, sensible and responsible effort to do the job they have taken on. This is as close as I can come to a general statement of the fiduciary duties of committee members.

3.24 This is as good a place as any to point out a particular trap for committee members. Incorporated associations are often short of committee members, and the positions are often taken on

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[13] Note 3 above. This article is also an excellent source of references on the subject of the liability of committee members of incorporated associations in WA and other States.

[14] Note 6 above.

[15] [1925] Ch 407; see also the other cases cited in *Daniels v Anderson*, 16 ACSR 607, 657.

[16] *Daniels v Anderson*, ibid.

[17] *Donoghue v Stevenson* [1932] AC 562, 580; cited in *Daniels v Anderson*, 16 ACSR 607, 665.

reluctantly. Even when taken on willingly, the incumbents can find that their circumstances change and they do not have enough time to do the job. The most common source of underperformance by committee members is not devoting enough time to do the job properly.

3.25 In *Daniels v Anderson*, the Court of Appeal applied a classic statement of the duty of care and diligence owed by company directors, made by the Supreme Court of New Jersey in *Francis v United New Jersey Bank*.[18] Some of the *Francis* principles can easily be adapted for application to incorporated associations, and they provide salutary reading for committee members who have a tendency to neglect their duties:

(a) A committee member should understand what the association does (including the broad outline of any laws that apply to the association's activities).

(b) Committee members are under a continuing obligation to keep informed about the activities of the association.

(c) Committee members have a duty to monitor the affairs of the association, and to do this they should hold and attend meetings regularly.

(d) Committee members should maintain familiarity with the financial status of the association by a regular review of financial statements. This may give rise to a duty to inquire further if the financial statements reveal problems.

Are committee members disadvantaged by the absence of statutory relief provisions?

3.26 Section 1318 of the *Corporations Act* permits a court to give relief to an officer of a corporation against civil liability for negligence, default, breach of trust or breach of duty, if the person:

(a) has acted honestly; and

(b) having regard to all the circumstances of the case, including those connected with the person's appointment, ought fairly to be excused.

3.27 There is no such provision in the *Associations Incorporation Act*. Of course, it has not been greatly missed so far, since there have been no cases on the liability of committee members. But if there was a case, would the defendant committee member be at greater risk of liability because of the absence of a relief provision?

3.28 In practice, I doubt if the absence of a relief provision will make much difference outside the insolvency area. The insolvency situation is different – more about that in section 4 below.

3.29 The main reason for my view that a relief provision would not make much difference to the risk of liability for breach of fiduciary duty is that in setting the liability standard, the courts can take an approach that is flexible enough to excuse conduct that would have qualified for relief. In other words, conduct that would have fallen within section 1324 is likely to be held not to amount to a breach of duty.

3.30 This contrasts with the statutory standards of liability for company directors, which have now been set at a relatively high level, creating the need for a "relief valve" for conduct falling short of the standards but justifying relief. That said, in the company director context relief is not granted very often. Applications for relief by company directors are frequently turned down on the ground that the case involves an element of moral turpitude, folly, or deliberate disregard or reckless neglect for the responsibilities of office. Neither company directors nor, I suggest, committee members of incorporated associations can expect any sympathy from courts where these elements are present.

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[18] 432 A 2d 814 (1981); cited in *Daniels v Anderson*, 16 ACSR 607, 666-7.

4. **Insolvency laws**

Corporations Act insolvent trading provisions – are they applicable to incorporated associations in WA?

4.1 It seems that the insolvent trading provisions in Part 5.7B of the *Corporations Act* – with their potentially onerous regime of personal liability for committee members - are intended to apply to incorporated associations, as State law. I say intended to apply, because whether they actually do apply is not free from doubt.

4.2 The process by which the provisions are purportedly applied is described in paragraph 1.6 above. Recapping briefly:

(a) The *Corporations Act* is disapplied as Commonwealth law, by the combined effect of section 3A of the *Associations Incorporation Act* and section 5F(2) of the *Corporations Act*. This step definitely does work!

(b) The *Corporations (Ancillary Provisions) Act 2001* (WA) provides (in Part 3) a mechanism for making specified provisions of the *Corporations Act* applicable to specified matters, as State law.

(c) Section 31(3) of the *Associations Incorporation Act* uses this mechanism to declare Part 5.7 of the *Corporations Act* applicable to the winding up (other than voluntary winding up) of an incorporated association.

4.3 Now it is fairly clear that steps (b) and (c) are effective to make Part 5.7 applicable, as if it was a law of Western Australia, to the non-voluntary winding up of an incorporated association. The only trouble is that Part 5.7 does not contain any substantive provisions. It just makes other provisions of the *Corporations Act* apply. The main provision is section 583 which says:

> Subject to this part, a Part 5.7 body may be wound up under this Chapter [*ie Chapter 5*] and this Chapter applies accordingly to a Part 5.7 body with such adaptations as are necessary, including the following adaptations:
>
> [*various adaptations are listed*]

4.4 By section 32(b) of the *Associations Incorporation Act*, section 583 is to be read as if references to a Part 5.7 body were references to an incorporated association.

4.5 The problem of interpretation is this: Part 5.7 is effectively applied, but it contains no substantive provisions. Part 5.7 itself purports to apply substantive provisions from elsewhere in the *Corporations Act*, but these are not provisions which are effectively made part of State law by the application procedure in the *Corporations (Ancillary Provisions) Act*.

4.6 The drafters of the 2001 and 2003 amendments to the *Associations Incorporation Act* clearly thought they were effectively incorporating Parts 5.4 to 5.6 (in 2001) and Parts 5.7B and 5.8 (in 2003). By way of reminder, Part 5.7B is the one that contains the insolvent trading provisions. This drafting intention is evident from section 32 of the *Associations Incorporation Act* which purports to make various modifications to the "incorporated" provisions of Parts 5.4 to 5.8.

4.7 However, the drafters' intention is not decisive and in this case, there is at least an argument that they have failed to achieve it. The basis for this argument is that where there is an explicit procedure prescribed by a State Act for application of (otherwise inapplicable) Commonwealth law as State law, it should be followed precisely. Here the procedure in sections 14 and 15 of the *Corporations (Ancillary Provisions) Act* has not been followed in relation to Parts 5.4 to 5.6 and 5.8 of the *Corporations Act*, because those provisions are not "specified" in the declaratory provision (which is section 31(3) of the *Associations Incorporation Act*).

4.8 The contrary argument, supporting the effective incorporation of Parts 5.4 to 5.6, 5.7B and 5.8, relies on section 21 of the *Corporations (Ancillary Provisions) Act*. This section says:

> Nothing in this Part prevents a law of the State from applying any provision of the Corporations legislation … as a law of the State otherwise than by means of a declaratory provision.

The argument is that Part 5.7 becomes a law of the State by means of a declaratory provision, then applies Parts 5.4 to 5.6 otherwise than by means of a declaratory provision. One wonders whether the drafters needed to be quite so cute, or to take such risks.

4.9 I apologise for that digression, which must have been incomprehensible to those readers who are not aficionados of statutory interpretation. Here's the bottom line:

- It is clearly intended that winding up of WA incorporated associations in insolvency should be governed by Parts 5.4 to 5.6, 5.7B and 5.8 of the *Corporations Act*, including the insolvent trading provisions.

- However, there is an argument that this intention was not effectively achieved. If this argument is correct, the insolvent trading provisions in Part 5.7B of the *Corporations Act* (along with the other provisions in Parts 5.4 to 5.6 and 5.8, as they relate to winding up in insolvency) do not apply to incorporated associations in WA.

4.10 Just in case the draftsman has got it right, we had better look at the potential effect on committee members of an insolvent incorporated association if Parts 5.4 to 5.6, 5.7B and 5.8 do apply. There are a number of fascinating legal issues around the way these provisions translate to incorporated associations, but I am going to focus on the potential liability of committee members under 2 provisions:

(a) section 588G and the related insolvent trading provisions; and

(b) liability under section 588FGA to indemnify the ATO against tax remittances that are clawed back from the ATO by the liquidator.

Insolvent trading provisions

4.11 Section 588G of the *Corporations Act*, if it applies to incorporated associations, imposes a duty on committee members to prevent their associations from incurring debts while insolvent. Broadly, an association is insolvent if it is unable to pay all of its debts as and when they become due and payable – *Corporations Act* section 95A.

4.12 Breach of the duty is not an offence, unless failure to prevent the association incurring the debt was dishonest. However, debts incurred in breach of section 588G may be recovered:

(a) by a liquidator, for the benefit of creditors generally – section 588M(2); or

(b) by the creditor to whom the debt is owed, with the liquidator's consent – sections 588M(3) and 588R-U.

4.13 In the majority of cases, recovery action is brought by the liquidator. Section 588G liability is dangerous, because in insolvency situations there is often a substantial loss to be recovered, and there is a potential plaintiff (the liquidator) with both a duty and a commercial incentive to recover the loss on behalf of creditors.

4.14 The basic liability principle under the insolvent trading provisions is "suspect in, expect out". In other words:

(a) If a reasonable person would have **suspected** that the association was insolvent, committee members are **in** the liability zone.

(b) Committee members can get **out** of the liability zone via the defence under section 588H(2), if they can prove they had reasonable grounds to **expect** and did expect that the association was solvent.

4.15 There are also 3 other defences, but none of them is very safe to rely on. They are:

(a) Section 588H(3): The committee member reasonably relied on information from a competent and reliable person, as a basis for the expectation that the association was solvent.

(b) Section 588H(4): Because of illness or some other good reason the committee member was not taking part in the management of the association at the time when the debt was incurred. Cases in the for-profit sector show that it is hard to make out a "good reason" for the purposes of this defence, because courts have a not unreasonable expectation that people who are responsible for corporate decision-making will do their job.

(c) Section 588H(5): The committee member took all reasonable steps to prevent the association from incurring the debt. Again, cases from the for-profit sector show that the words "all reasonable steps" set a high standard.

4.16 An extensive and quite complex body of law has built up around insolvent trading. A full examination of the subject is beyond the scope of this paper.[19] However, some observations can be made about how the insolvent trading provisions would translate into the not-for-profit sector through the *Associations Incorporation Act*.

4.17 First, the insolvent trading provisions do not hold many terrors for small associations with low turnover, because the sheer volume of their indebtedness is at all times low. Remember, the personal liability risk is for the shortfall in paying creditors in an insolvency situation. Small associations run little insolvency risk and if they did become insolvent, the shortfall in payments to creditors should not be large.

4.18 On the other hand associations with a significant turnover, such as schools, need to take insolvent trading risks seriously. The best ways for committee members in these associations to mitigate insolvent trading risks are:

(a) Ensure that the financial affairs of the association are in the hands of a competent and reliable manager (whether in-house or outsourced). This will have a cost, but take my advice and don't skimp on this cost. If the association's turnover is significant, committee members must get the organisation's financial affairs looked after by someone with the requisite financial skill and time.

(b) Require regular financial reports from the manager, and ensure that all committee members receive these, read them and discuss them at meetings. **The reports received must include cash flow projections**. These should be checked carefully: brackets in the bottom line are the danger signal! Remember, cash flow projections are only as good as the assumptions used in compiling them, so don't be afraid to challenge the assumptions.

(c) If the cash flow statements show that the association is in or near an insolvent state, take urgent professional advice. If the professional advice confirms that the association is or will become insolvent, the committee members should apply for a winding-up order. Note that

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[19] A high-level review of insolvent trading provisions and their history is presented in P James, I Ramsay and P Siva, *Insolvent Trading – an Empirical Study*, (2004) Clayton Utz and the Centre for Corporate Law and Securities Regulation, University of Melbourne. For a recent and comprehensive judicial examination of relevant principles see the *Water Wheel* case, *Australian Securities and Investments Commission v Plymin & Ors* [2003] VSC 123; (2003) 46 ACSR 126; 21 ACLC 700; (2003) 175 FLR 124. The legislative history of the insolvent trading provisions is reviewed in *Deputy Commissioner of Taxation v Clark* [2003] NSWCA 91; (2003) 57 NSWLR 113; 176 FLR 235; 45 ACSR 332; 21 ACLC 1063; 52 ATR 526.

the "interim" step of voluntary administration available to companies under Part 5.3A of the *Corporations Act* is definitely not available to incorporated associations, because the *Associations Incorporation Act* does not even try to make it applicable.

(d) If possible, ensure that the association has a directors' and officers' (**D&O**) insurance policy that covers committee members against insolvent trading risks.

4.19 If the insolvent trading provisions do apply to incorporated associations, honest committee members who have acted reasonably but still find themselves caught in the insolvent trading web definitely have less protection than their for-profit company counterparts. This is because the relief provision in section 1318 of the *Corporations Act* (successor to the provision which Mr Eise tried to rely on in the National Safety Council case referred to above) is not (even purportedly) applied as State law by the *Associations Incorporation Act*. There is no clear policy reason why committee members should be deprived of this opportunity to claim relief. It looks like another example of imperfect translation of the insolvency regime from the *Corporations Act* to the *Associations Incorporation Act* context.

Section 588FGA – indemnity to ATO against clawback of tax remittances by liquidator

4.20 Section 588FGA of the *Corporations Act* is another provision which is only likely to concern larger associations with a number of employees. The section would apply in the context of an incorporated association when:

(a) The association had paid tax to the ATO under the provisions of tax legislation which require deductions to be made from payments to employees or third parties. The most familiar of these is the requirement to make and remit PAYG deductions under Part 2-5 in Schedule 1 to the *Taxation Administration Act*. Prescribed payments and dividend, interest and royalty withholdings are also among the tax payment obligations which feed into section 588FGA, but it does not apply to GST.

(b) The association goes into liquidation after making the payment.

(c) The liquidator challenges the payment to the ATO as a voidable transaction under section 588FE of the *Corporations Act*. The most common voidable transaction will be a payment made within 6 months before the commencement of winding-up. This will be an "unfair preference" under section 588FA if it gives the ATO, as an unsecured creditor, a greater benefit than it would have obtained by proving in the winding-up. A payment which is an unfair preference is an "insolvent transaction" under section 588FC if the payment is made at a time when the association is insolvent, or if the payment has the effect of making the association insolvent.

(d) The liquidator succeeds in getting a court order for the ATO to return the payment to the liquidator under section 588FF.

4.21 When all of the above conditions are met, any person who was a committee member of the association at the time the tax was originally remitted to the ATO will be personally liable to indemnify the ATO for the amount it has had to pay back – section 588FGA(2). The liability is effectively joint and several – section 588FGA(5).

4.22 The policy underlying section 588FGA is that if an association is insolvent, the committee members should apply for winding-up rather than making a preferential payment to the ATO.

4.23 Cases from the for-profit sector show that where the ATO finds itself on the receiving end of a clawback claim from a liquidator, it can and often will join directors in the action and claim indemnity from them. Whether the ATO would be more forbearing in the case of an insolvent not-for-profit association remains to be seen.

Income Tax Assessment Act Part VI, Division 9 – personal liability for unremitted PAYG deductions

4.24 I hope I haven't used up your attention span, because I have another conundrum for you. Does Part VI, Division 9 of the *Income Tax Assessment Act 1936* (Cth) ***(ITAA***) apply to committee members of incorporated associations – and if so, what on earth does it mean?

4.25 I can help with the second part of this, having studied the application of the provisions to companies. The provisions as they operate in relation to companies are outlined in paragraphs 4.27 to 4.35 below. I will then look at whether it is possible to translate the application of the provisions from directors of companies to committee members of incorporated associations.

4.26 But please note: once again, these provisions will only be relevant to associations with a significant workforce, which are required to make PAYG deductions each month. The effect of the provisions is to make directors/committee members personally liable for unremitted PAYG tax and similar deductions. Unless the association or associations you are interested in are liable to remit PAYG or prescribed payments, I suggest you conserve brain capacity and skip to section 5.

4.27 The provisions imposing personal liability on directors are in Part VI Division 9. Division 9 starts with a no-nonsense statement of intent, in section 222ANA(1):

> The purpose of this Division is to ensure that a company either meets its obligations [under the various provisions requiring remittance of amounts deducted or withheld], or goes promptly into voluntary administration under Part 5.3A of the Corporations Act 2001 or into liquidation.

4.28 Division 9 operates where a company has obligations to deduct amounts from payments to third parties – notably PAYG tax, but also prescribed payments etc (but not GST) – and remit the deductions to the ATO. The initial proposition in Division 9 is that where a company has remittance obligations, the directors must cause the company to do one of four things before the date when the payments are due to be remitted to the ATO:

(a) remit the payments as required by the legislation;

(b) enter into a written payment agreement under section 222ALA;

(c) appoint an administrator under section 436A of the *Corporations Act*; **or**

(d) commence winding-up (note that winding-up commences only when a winding up order is made by a court[20]).

The provisions dealing with deductions and withholdings from payments to employees or other parties are in section 222AOB. There are parallel provisions in sections 222AOBAA (alienated personal services payments) and 222AOBA (non-cash benefits).

4.29 The four steps listed above recur throughout Division 9 as a menu of options, one of which must be chosen and implemented if directors are to avoid personal liability. To save repetition I will refer to them as the **four anti-liability measures**.

4.30 If none of the four anti-liability measures is taken on or before the due date, anyone who was a director of the company between the time the deduction was made and the time when it was due to be remitted to the ATO is personally liable for a penalty equal to the amount of the unpaid remittances – section 222AOC. A director who pays the penalty can recover contribution from fellow directors and/or sue the company for indemnity – or (more likely in practice) prove in its liquidation as an unsecured creditor. The recovery principles are the same as if the directors had given a joint and several guarantee of the company's tax liability – section 222AOI.

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[20] *Re Scobie; ex parte Deputy Commissioner of Taxation* (1995) 95 ATC 4525, 4532; (1995) 59 FCR 177; (1995) 13 ACLC 1318.

4.31 The personal liability net is cast wider by section 222AOD. Under that section, liability for the penalty extends to anyone who becomes a director after the due date, and before one of the four anti-liability measures has been taken – unless the new director causes one of the four anti-liability measures to be taken within 14 days after being appointed.[21]

4.32 Section 222AOD has the potential to give new directors a nasty surprise. A key part of the due diligence exercise that directorship candidates should go through before accepting appointment is to establish that there is no liability for unremitted tax deductions. Equally, continuing directors should continually inform themselves on whether remittances are up to date.

4.33 Even where they have become personally liable under Division 9, directors do get one last chance. The ATO cannot commence proceedings to recover the penalty unless and until a warning notice has been given under section 222AOE. A director who receives a section 222AOE warning notice has 14 days to cause one of the four anti-liability measures to be taken: making payment, entering into a payment agreement, appointing an administrator or obtaining a court order for winding-up. If one of these four things is done in the 14-day window after receipt of the notice, the penalty is automatically remitted; but if not, the ATO is free to sue the director for the penalty.

4.34 Focusing on how Division 9 applies to PAYG deductions, as a matter of logic the analysis appears to be:

(a) The basic obligation arises under section 222AOB. It attaches to people who are directors at any time between the time of the deduction and the time when remittance is due, under section 222AOB(1). Where the obligation is not met an ongoing obligation attaches to people who are directors at any time after the due date for remittance, under section 222AOB(3).

(b) If the basic obligation under section 222AOB(1) is not complied with by the due date:

(i) Everyone who was a director at any time between the first deduction date for the month and the due date for remittance becomes liable for a penalty equal to the unremitted deductions, under section 222AOC(1).

(ii) Everyone who becomes a director after the due date for remittance becomes liable for the same penalty, unless they cause one of the four anti-liability measures to be taken within 14 days after their appointment.

(c) The ATO must give the warning notice as a condition precedent to suing to enforce the penalty liability.

(d) Taking one of the four anti-liability measures within 14 days after receiving the warning notice operates as a condition subsequent to the director's liability for the penalty.

4.35 One can imagine the drafters congratulating themselves on the sheer elegance of this logical scheme. Unfortunately, in the real world the labyrinthine complexity of Division 9 has made it a prolific source of confusion for directors and advisers - and even for the ATO and the courts.

4.36 As if that was not enough complexity, we now need to consider whether Part VI, Division 9 applies to committee members of incorporated associations. It appears that it was intended to, since:

(a) The general *ITAA* definition of "company", which applies for the purposes of Part VI, Division 9, extends to "associations corporate or unincorporate".

(b) The specific definition of "director" in Part VI, Division 9 (section 222AFB) says:

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[21] It does not help a new director to say he did not know about the debt. He has a duty to find out: *Fitzgerald v Deputy Federal Commissioner of Taxation* (1995) 95 ATC 4587; (1995) 14 SR (WA) 356; (1995) 13 ACLC 1547.

"director" in relation to a company:

(a) means someone who is a director of the company for the purposes of the *Corporations Act 2001*; and

(b) in the case of an unincorporated company – includes an officeholder of the company.

4.37 It will be seen that there is a hiatus in the drafting within the definition of "director". It does not readily apply to bodies falling within the definition of "company" which are incorporated, but not incorporated under the *Corporations Act* – for example, associations incorporated under the *Associations Incorporation Act* (WA).

4.38 If I had to call this one, I would expect a court to adopt an interpretation of the definition of "director" that did allow Part VI, Division 9 to apply to committee members of incorporated associations. One approach would be to interpret "unincorporated company" as meaning any company not incorporated under the *Corporations Act*. Another would be to say that a committee member can be a director of an incorporated association for the purposes of the *Corporations Act*, even though the *Corporations Act* does not apply to incorporated associations. Both interpretations are a little artificial, but the alternative is to recognize one category of corporate PAYG remitters whose office-holders are not subject to personal liability when deductions are not remitted to the ATO. I think courts would try to avoid this outcome.

4.39 Assuming that Part VI, Division 9 does apply to the committee members of incorporated associations that are PAYG remitters, how can they manage the personal liability risk?

4.40 The answer is:

(a) Committee members must carefully monitor both PAYG remittances, and the solvency of the association.

(b) As long as the association remains solvent and capable of paying PAYG remittances along with its other debts, it is simply a matter of checking that there has been no forgetful or dishonest failure to remit.

(c) If the association has cash flow problems and cannot readily meet PAYG liabilities, go immediately and urgently to paragraph 4.18 step (c) above.

5. Activity-specific legislation

5.1 Like any other member of the community, an incorporated association will be subject to laws that govern its activities. Some of these laws contain provisions imposing liability on directors/committee members, where an incorporated body breaches the law. The theory underlying this is that it is supposed to encourage decision-makers to ensure that the affairs of the incorporated body are conducted in a way that ensures the law is not breached.[22]

5.2 An example of this type of legislation, which will apply to the activities of many associations incorporated in WA, is the *Occupational Safety and Health Act 1984* (WA) (***OSH Act***). The *OSH Act* requires associations to provide a safe and healthy environment for employees, contractors and visitors.

5.3 Section 55 of the *OSH Act* provides that where a body corporate commits an offence under the Act, "any director, manager, secretary or other officer of the body, or any person who was purporting to act in any such capacity" will (in broad terms) be guilty of the same offence if the offence occurred with their consent or connivance, or was attributable to any neglect on their part.

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[22] For an analysis of this subject see *Personal Liability for Corporate Fault,* Corporations and Markets Advisory Committee Discussion Paper, May 2005.

5.4 Although the *OSH Act* does not contain a definition of "director", committee members of incorporated associations will certainly fall within the range of persons who may be liable under section 55.

5.5 OSH offences carry substantial fines and in the case of offences involving serious harm or death as a result of gross negligence, possible prison terms. It follows that committee members are well advised to take OSH responsibilities very seriously.

6. Accessorial liability

6.1 Some laws of general application impose liability for contraventions by persons or corporations (including incorporated associations) and also impose accessorial liability on persons involved in the contraventions. Committee members, as the persons making decisions for incorporated associations, may be exposed to personal accessorial liability where the association contravenes a law of this kind.

6.2 An example of this is if the incorporated association engages in misleading or deceptive conduct in trade or commerce.[23] Note that the misleading or deceptive conduct provisions of the *Fair Trading Act* only apply when the incorporated association is acting in trade or commerce. This will not apply to all of an incorporated association's activities, only those activities that have a business-like nature.

6.3 If a committee member is "involved" in an incorporated association's misleading or deceptive conduct, the committee member may be personally liable to compensate anyone who has suffered loss as a result of the contravening conduct.[24]

6.4 A committee member is involved in the incorporated association's breach if they have:

(a) aided, abetted, counseled or procured the contravention; or

(b) induced, whether by threats or promises or otherwise, the contravention;

(c) been in any way, by act or omission, directly or indirectly, knowingly concerned in, or party to, the contravention; or

(d) conspired with others to effect the contravention.[25]

6.5 The third category of involvement ("knowingly concerned") is potentially very wide. It raises a practical issue, which translates into a personal governance standard that all prudent committee members should adopt. If the association's committee plans to make a decision that a committee member knows is likely to result in misleading or deceptive conduct (or for that matter, is likely to be wrong for any other reason), it is not enough for the committee member to withdraw from participating in that decision. The proper approach is for the committee member to stand up and be counted: that is, to state his or her position on the matter and actively try to convince the other committee members not to come to a decision that is legally or morally wrong. Of course, this is a two-way process and the committee member must also be prepared to listen to the arguments of other committee members about why the proposed action is in fact proper and appropriate.

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[23] Section 10 of the *Fair Trading Act 1987* (WA) (**FTA**). The misleading or deceptive conduct provisions are also found in the *Trade Practices Act 1974* (Cth) (**TPA**). However, the provisions of the TPA only apply to "corporations", which does not include incorporated associations. The FTA applies to "persons", which includes incorporated associations.

[24] See section 79 of the *Fair Trading Act*.

[25] Section 68 *Fair Trading Act*.

7. **Criminal Code**

7.1 At the risk of stating the obvious, the *Criminal Code* will apply to dishonest conduct engaged in by a body corporate or its officers.

7.2 If an incorporated association commits an offence under the *Criminal Code*, committee members will also be deemed to be primary offenders if they:

(a) counsel or procure the incorporated association to commit the offence; or

(b) do or omit to do any act for the purpose of enabling or aiding the incorporated association to commit the offence.[26]

7.3 Committee members may also be guilty of an offence if they engage in any of the following dishonest conduct:

(a) If committee members do or omit to do any act with respect to the property of the incorporated association which, if they were not committee members, would constitute an offence, they will be criminally responsible to the same extent as if they were not committee members. This simply means that committee members cannot treat the incorporated association's property as their own.

(b) If a committee member, with intent to defraud:

(i) makes a false entry in any record of the incorporated association;

(ii) omits to make an entry in any record of the incorporated association;

(iii) gives any certificate or information which is false in a material particular in relation to the incorporated association;

(iv) by any act or omission falsifies, destroys, alters or damages any record of the incorporated association; or

(v) knowingly produces or makes use of any record of the incorporated association which is false in a material particular,

they will be guilty of an offence and may be liable to imprisonment for up to 7 years.[27]

(c) A committee member who corruptly receives or solicits from any person, for himself or for any other person, any valuable consideration (eg a secret commission or gift):

(i) as an inducement or reward for doing something or not doing something in relation to the incorporated association's affairs; or

(ii) the receipt or expectation of which would in any way tend to influence the committee member to show favour or disfavour to any person in relation to the incorporated association's affairs,

will be guilty of an offence.[28] Note that it is also an offence to give or offer committee members any secret commission or gift.[29]

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[26] Section 7 of the *Criminal Code*.

[27] Section 424 of the *Criminal Code*.

[28] Section 529 of the *Criminal Code*.

8. Ratification, indemnity and insurance

8.1 A committee member's fiduciary obligations are owed to the association. Consequently, the association is generally able to condone or ratify a breach by a committee member of their fiduciary duty.[30] Ratification by all the members in general meeting (or a majority if the rules permit) will generally put an end to the liability.[31]

8.2 For ratification to be effective, the consent of the members must be fully informed. That is, there should be disclosure of the nature and extent of the breach, with all supporting information that the "average commercial man in the street" would think that the members should have.[32] While too little information will be a problem, in some cases too much information or poorly presented information may also cause difficulties.[33]

8.3 There is authority that a director is not restricted from voting as a member with respect to the ratification of his or her own breach of duty.[34] However, this approach has become less popular in modern times and the application of this principle has been substantially eroded by the *Corporations Act* and regulatory policies. In view of an incorporated association's not-for-profit nature the argument for permitting members to vote in a self-interested manner to approve their own breaches of duty is even weaker.

8.4 An association's ability to ratify breaches of duty by committee members has its limits. Australian courts seem to be developing a principle that members of a company must exercise their power for proper purposes. By analogy, the power of the members of an association to ratify breaches of duty by committee member is likely to be restricted where it would:[35]

(a) constitute a fraud on the minority;

(b) constitute a misappropriation of the association's resources; or

(c) permit a fraudulent (or perhaps reckless) breach of duty.

8.5 If insolvent trading provisions apply, the liability they impose is statutory and cannot be relieved by ratification.

8.6 It is not clear that all breaches of duty can be effectively forgiven by an association without some consideration.[36] Consequently it is prudent for the members' ratification resolution to authorize the giving of a deed of release in support of the ratification.

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[29] Section 530 of the *Criminal Code*.

[30] *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134, 139, 150 and 157; *Furs Ltd v Tomkies* (1936) 54 CLR 583, 592.

[31] *Bamford v Bamford* [1970] Ch 212; *Winthrop Investments v Winns Ltd* [1975] 2 NSWLR 666.

[32] *Buttonwood Nominees Pty Ltd v Sundowner Minerals NL* (1986) 10 ACLR 360.

[33] Ibid.

[34] *North-West Transportation Company Ltd v Beatty* (1887) 12 App Cas 589; *Burland v Earle* [1902] AC 83.

[35] See *Miller v Miller* (1995) 16 ACSR 73.

[36] The general law duty of care and skill are not fiduciary duties, but matching common law and equitable duties, the former arising out of the proximity of the committee member and the association: See *Permanent Building Society (in liq) v Wheeler* (1994) 14 ACSR 109; *Daniels t/as Deloitte Haskins & Sells v AWA Ltd* (1995) 37 NSWLR 438.

8.7 As noted above, the limits on exemptions and indemnities in section 199A of the *Corporations Act* do not apply to incorporated associations. As a result, it is possible for incorporated associations to adopt constitutions which discharge committee members from liability for breaches of their duties to the association, and/or indemnify committee members against liability to third parties. In proposing provisions of this nature to their members, committee members must weigh up the natural desire for self-protection against principles of accountability and responsibility.

8.8 Similarly, restrictions imposed by section 199B of the *Corporations Act* on companies obtaining insurance for officers against liability for conduct involving wilful breach of duty do not apply to incorporated associations.

8.9 Small associations without significant turnover may not have the financial substance, or the need, to take out D&O liability insurance. But if the association has a substantial turnover or engages in activities generating potential liabilities under legislation such as the *OSH Act*, committee members would be well advised to obtain at least some level of D&O cover if they can. A word of warning: D&O policies should be read carefully (preferably with the benefit of advice from an experienced lawyer) and any ambiguities or apparent gaps should be clarified.

9. Volunteers (Protection from Liability) Act 2002

9.1 Committee members who receive no remuneration for their committee work may seek to rely on the protection from civil liability conferred by the *Volunteers (Protection from Liability) Act 2002* (WA) (**VPFLA**).

9.2 The table in the Annexure sets out my views on whether VPFLA protection applies to the liabilities discussed in this paper.

9.3 Unfortunately, my conclusion is that for most of the liabilities discussed above, the VPFLA does not give clear protection to volunteer committee members. Reasons for this view are:

(a) Criminal liabilities are not covered. Protection undert the VPFLA is limited to civil liability – section 6(1).

(b) Conduct involving a lack of good faith is not protected – section 6(1).

(c) Significantly, the protection is limited to liabilities incurred "when doing community work" – section 6(1). "Community work" is defined in section 3(1) as meaning **work organised by a community organisation** (including an incorporated association) to be done for a defined range of non-profit purposes. It does not appear that the governance activities of an incorporated association (including the organising of its work) are included within the concept of "community work".

(d) Section 7 preserves the liability that would otherwise fall on the volunteer, but transfers it to the organisation. It is clearly not appropriate for this to apply to a liability of the volunteer to the association itself (such as a liability for breach of general law duties). This reinforces the argument in (c) above that liabilities of this kind do not fall within the scope of the VPFLA.

(e) Liabilities such as:

(i) the penalties imposed on committe members for failure to remit PAYG tax instalments under Part VI Division 9 of the *ITAA*; and

(ii) civil liability of committee members for insolvent trading

are based on a policy of *ex officio* accountability of decision-makers for governance defaults. These liabilities do not arise from involvement in the community-facing non-profit work of the organisation, and are not within the protected scope of "community work".

9.4 There is nothing to contradict these views in the explanatory memorandum which accompanied the Bill for the VPFLA. The only commentary I have been able to find supports my conclusion.[37] In Queensland and NSW the corresponding legislation specifically extends to volunteer officeholders. Whether the coverage of the WA legislation should be similarly extended is a matter which might usefully be considered in the course of the current review of the *Associations Incorporation Act* and related issues.

9.5 In light of the views expressed above I strongly recommend that committee members rely for protection against liability on 3 things:

(a) doing their job diligently;

(b) D&O insurance, if available and affordable; and

(c) release and indemnity under the constitution of the incorporated association, if appropriate and supported by members

and not on any expectation of a "get out of jail card" under the VPFLA.

10. Conclusion

10.1 Committee members of incorporated associations will no doubt be dismayed to learn that they are surrounded by such a complex web of potential liabilities. However, they may take heart from the fact that so far, there have been very few cases where committee members have been held liable for anything.

10.2 There is a distinct difference in risk profile as between big and small incorporated associations. The most dangerous set of risks, those which arise when the association is in or near insolvency, are really only significant for associations with substantial turnover. There is a degree of uncertainty about application of the insolvent trading provisions to incorporated associations in WA, which is unfortunate – although of course the uncertainty may benefit anyone who is able to use it to escape liability.

10.3 It is essential for committee members in large associations to take the steps listed in paragraph 4.18 above, remember the principles listed in paragraph 3.25 above, and keep a close eye on PAYG remittances.

10.4 Even in small associations, it is unwise to ignore potential liabilities. The committee members of incorporated associations are unlikely to be completely immune from the effects of increasing community expectations about corporate governance – not to mention the increasing prevalence of litigation.

10.5 Consider the case of an association which runs a community hall. The committee members are very busy – too busy to check either the floorboards in the hall, or the currency of the association's public liability insurance policy. The floorboards are eaten by white ants and they collapse under the weight of a party of revellers. A number of the guests are injured, some seriously. They sue the association, which goes into liquidation. There is a significant risk that the liquidator will sue the committee members personally, for breach of their duty of care. Would the claim succeed? Would the committee members be protected by the *Volunteers (Protection from Liability) Act*? I am sure none of the committee members and association advisers who are reading this paper would have any desire to be involved in the test case.

10.6 The example shows that whatever the size and function of the association, committee members must:

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[37] Myles McGregor-Lowndes and Linh Nguyen, "Volunteers and the new tort law reform", (2005) 13 *Torts Law Journal* 41, 48ff.

(a) pay diligent attention to the affairs of the association; and

(b) maintain proper insurance coverage for the association's activities– at least for public liability and if financial circumstances and needs justify it, for D&O liability as well.

Leigh Warnick

1 June 2005

ANNEXURE

Liability source	Does VPFLA apply?	Why?
Associations Incorporation Act	No	Criminal liability
General law duties – good faith	Probably not	See note 1
General law duties – bad faith	No	Lack of good faith
Corporations Act section 588G – insolvent trading	Probably not	See note 2
Corporations Act section 588FGA – tax clawback indemnity	Probably not	See note 2
ITAA Part VI Division 9 – personal liability for unremitted PAYG	No	Penalty liability under Commonwealth Act – and see note 2
*OSH Ac*t	No	Criminal liability
Fair Trading Act – misleading or deceptive conduct – liability as "person involved"	Possibly	See note 3
Criminal Code	No	Criminal liability

Note 1: See paragraphs 9.3(c) and (d) of paper.

Note 2: See paragraphs 9.3(c)-(e) of paper.

Note 3: This liability may be covered, if the conduct does not involve bad faith and is done in the course of "community work" as opposed to governance activities – see paragraph 9.3(c) of paper.