

DIVERSIONS OF CHARITABLE ASSETS: CRIMES AND PUNISHMENTS IN AUSTRALIA

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Overview

The Australian context

While it is estimated that there are some 700,000 nonprofit organisations in Australia,¹ there are only about 44,000 strictly English or 501(3) c “charitable” institutions or funds.² The nonprofit sector employs 6.8% of the Australians in employment (similar to the US, but larger than the UK) and contributed 3.3% to GDP. Its sources of income are about 58% from the sale of goods and services, 30% from government contracts and fees and 9% from household transfers.³ Compared to the US and the UK, the Australian sector is more reliant on fees and charges and has less philanthropic income.⁴

During 2000, 4.4 million (33%) Australians volunteered (excluding the Sydney Olympics) a total of 704.1 million hours of labour for nonprofit organisations of all sizes. This voluntary contribution was equivalent to an additional \$8.9 billion worth of income to the nonprofit sector. Including volunteer labour boosts the sector’s contribution to GDP to 4.9%.

Australian charitable trusts

Australian laws regarding charitable trusts follow very closely the English common law. As such, charitable trusts have two characteristics that set them apart from ordinary trusts. They are for certain purposes that must be for the public benefit, rather than for specific individuals, and they are the only category of trust that has perpetual succession. Diversion of the assets of a charitable trust may be contrary to the law or demanded and facilitated by the law.

Diversion of charitable assets occurs contrary to the law when there is:

¹ Lyons, Mark, *Third Sector: The Contribution of Nonprofit and Cooperative Enterprises in Australia*, Crows Nest: Allen and Unwin, 2001.

²ATO personal correspondence.

³ Australian Bureau of Statistics, *Nonprofit Institutions Satellite Account*, Cat No. 526.0, Canberra, 2002.

⁴ Salamon, L.M., S.W. Sokolowski and R. List, *Global Civil Society: An Overview*, The Johns Hopkins Comparative Nonprofit Sector Research Project: Baltimore, 2003.

- a departure from the stated purpose of the trust to another purpose; or
- the direct benefit of specified individuals outside the purposes of the trust.

Diversion of charitable assets is demanded and facilitated by the law where a charitable trust can no longer fulfill its purposes because:

- it does not have sufficient income or capital;
- the purpose is no longer relevant;
- the trust ceases to operate; or
- the trust has excess funds.

In the first instance, it is a matter of bringing those responsible for the diversion to justice and restoring the assets to their appropriate charitable use. Each state Attorney-General has the prime responsibility for bringing these proceedings. In Australia, there is no equivalent of the Charity Commission (England and Wales) or the IRS (US) who performs the role of a charity regulator.

In the second instance, it is a matter of the lawful diversion of assets because of a frustration of the original charitable purpose by the course of events. A common law doctrine of *cy prés* operates as a positive duty on trustees to seek the guidance of the courts to redirect the funds to purposes as near as possible to the original intention of the donors. This usually involves the Attorney-General as the protector of charities and the court in approving the changed purposes. In Australia, *cy prés* applications are notoriously expensive and delayed.

Are Australian charitable assets being diverted?

Over the last decade, Australia has had charity scandals, as noted in Gibelman and Gelman's analysis of wrongdoing by nongovernmental organisations which drew on alleged or actual scandals in countries such as the United States, the UK, Germany,

France, Ecuador, Ireland, Israel, and Scotland.⁵ There is certainly a level of petty theft in nonprofit organisations, as in any type of organisation but, unlike the US, there have been no significant controversies about excessive executive remuneration (United Way), pyramid financing schemes (New Era), taxation fraud, large fundraising fraud, self-dealing by foundations or inappropriate health industry conversions. Inappropriate sexual behaviour within religious institutions has been the most prolific and notable scandal in Australia over the last decade. Indigenous organisations have been embroiled in significant and serious diversions of charitable assets, but these form only a small part of the Australian nonprofit sector and are significantly unrepresentative of the wider sector because of special circumstances.

Australia's largest nonprofit insolvency did not involve any diversion of charitable assets.⁶ The Chief Executive Office defrauded 27 Australian and international financial institutions of loan monies through illusory securities. These loan funds made the organisation into one of the best rescue organisations in the world, but nothing was diverted and the CEO did not personally profit. The Australian Red Cross was criticised for its management of the Bali bombing appeal, but was later cleared by an independent investigation of any fraud or misuse of donor funds.⁷ The major issue was the effectiveness of its communication systems with victims and the public, rather than diversion of assets to fraudulent, inappropriate or illegal purposes.

Reasons for this lack of 'diversion scandals' compared to other developed countries is a puzzle. It may be that diversions are undetected due to the lack of an effective central regulator and generally uninterested popular media. As Australian nonprofit bodies are heavily membership driven and professionally audited, this encourages close scrutiny of activities, preventing abuse. Organisations may cover up diversions when discovered by insiders to protect the reputation of the organisation. The smaller reliance on

⁵ Gibelman, M. and S. R. Gelman, "Very Public Scandals: Nongovernmental Organizations in Trouble", *International Journal of Voluntary and Nonprofit Organizations*, 12(1), 2001, pp.49-66.

⁶ Refer: McGregor-Lowndes, M., "Nonprofit Corporations – Reflections on Australia's Largest Nonprofit Insolvency", *Australian Journal of Corporate Law*, 5(4), December 1995, pp. 417-441; *Commonwealth Bank of Australia v Friedrich* (1991) 9 ACLC 946.

⁷ Australian Red Cross, *Review of the Issues Surrounding the Administration of the Bali Assistance Fund*, Australian Red Cross:Sydney, 2003; Department of Gaming and Racing, *Report of the Inquiry into the Australian Red Cross Bali Appeal*, Depart of Gaming and Racing, New South Wales: Sydney, 2003.

fundraising and philanthropy combined with a comparatively restrictive tax regime for charitable tax deductions may also create less fertile ground for diversion. Finally, it may just be that there are few diversions of any note.

Structure of the paper

The first part of the paper examines the English legacy of law and regulatory administration. Australia has adopted the English common law, but has not developed a Charity Commission model for the regulation of the fidelity of charitable organisations. The paper then turns to examining the evidence of charity asset diversions through an examination of government inquiries and reports. The legal process remedying illegal diversions and facilitating appropriate diversions is then examined. Both of these processes involve the state Attorneys-General. Finally, the future challenges in respect of charitable asset diversions are discussed.

The English legacy of charity supervision for Australia

Australia received English common law at the time of colonisation. The common law of charitable trusts and charity still dominates the legal and regulatory landscape. Although Australia adopted the common law of charities originating in the *Statute of Charitable Uses of 1601*⁸ (Statute of Elizabeth), it has not adopted the English regulatory agency model that primarily focuses on charities. This lack of a central regulatory body is increasingly seen as a deficiency in the Australian regulatory environment of the nonprofit sector.

The problem of adopting a law without its supporting administrative structures has not been appreciated. For example, while the English Statute of Elizabeth is known for its preamble providing the origins of the common law definition of charity, the overt purpose of the statute was as part of the package of Poor Law reforms⁹ to deal with the economic and social problems of the time.¹⁰ The statute provided a new method of

⁸ 43 Eliz. I, c.4.; this act is a modification of a prior *Statute of Uses* in 1597, 39 Eliz. I, c.6.

⁹ 43 Eliz. I, c.2. dealt with such issues as declaring all beggars who requested anything but food rogues, and making parents and grandparents liable for the maintenance of children or grandchildren; 43 Eliz. I, c.3. dealt with the provision of pensions to maimed soldiers from local taxes.

¹⁰ There was, at the time, a series of disastrous harvests, the protracted Spanish war, inflation, a domestic and international economic depression and the plague which killed 14 per cent of the population of London. This led to rapidly changing social conditions causing poverty, unemployment and vagrancy. The

regulating charities other than through the courts.¹¹ It sought to ensure that funds did not become dormant or misused. The Chancellor, and later the Office of the Attorney-General, as *parens patriae* was responsible on behalf of the Crown for protecting charitable trusts and had sole standing to initiate actions against charitable trusts.¹² While in Thomas Moore's day the Chancellor and the Court of Equity that had authority over charity provided a cheap and speedy remedy for the abuses and failures of charitable trusts, by the reign of Elizabeth, delays, expense and technical complexities put the justice of the court of equity out of the reach of all except the very wealthy.¹³ As will be discussed below, this situation still largely exists in England's former colony, Australia, to this day.

Later, when the Benthamite utilitarians of the early nineteenth century were measuring the efficiency and effectiveness of many institutions of British society, they turned to English charities. The Brougham Inquiry 1819-1837 was one of their amazing Royal Commissions that has few rivals in any other Royal Commission at that time or since.¹⁴ The inquiry grew out of a select parliamentary committee into the provision of education, which highlighted the abuse some educational institutions made of charitable donations.¹⁵

The Brougham Inquiry lasted for nearly two decades, cost nearly four million pounds, and produced forty volumes of reports and digests. These comprised more than thirty-eight thousand pages and encompassed over twenty-nine thousand charities.¹⁶ It is estimated that it conservatively recovered over thirteen million pounds in assets that were being misused or under-utilised. Four hundred charities were prosecuted by the Attorney-General.¹⁷ The Inquiry found in approximately twenty-five per cent of the cases some

laws initiated by Henry VIII comprised local rate levies which were distributed by local authorities to the deserving poor or for creating work.

¹¹ Gray, B.K., *A History of Philanthropy: From the Dissolution of the Monasteries to the Taking of the First Census*, Frank Cass & Co. Ltd: London, 1967 at p.35; Jordan, W.K., *Philanthropy in England 1480-1660: A Study of the Changing Pattern of English Social Aspirations*, George Allen & Unwin Ltd: London, 1958 at p.83; Jones, G., *History of the Law of Charity: 1532-1827*, Wm. W. Guant & Sons Inc: Florida, 1986, at p.16.

¹² The doctrine of *parens patriae* is the inherent power and authority of the state to provide protection of non *sui juris* persons such as children, the insane and incompetent persons. The monarch was regarded as the "father of his country".

¹³ Jones, *op. cit.* at p.20.

¹⁴ Although referred to as the Brougham Inquiry, it was really two inquiries, the Inquiry of the Commissioners on the Education of the Poor, 1818, and the Inquiry of the Commissioners on Charity, 1819.

¹⁵ Great Britain, Select Committee on the Education of the Poor in the Metropolis, *Hansard*, XXXIV, 1816.

¹⁶ Hargraves, B., *The Reform of the Law and Administration of Charities in the Nineteenth Century*, unpublished doctoral thesis No.167, University of London, 1969, at p.11.

¹⁷ Thompson, R., *op. cit.*, at p.182; the ability of the Commission to refer charities to the Attorney-General was very limited and the figure does not represent accurately the extent of the abuses of charitable trusts. Informal pressure of investigation and publicity served to remedy many other specific abuses of charities.

major cause to criticise the management of the trust.¹⁸ Only the worst of the abuses were included, as Owen notes,

Although the trustees were observing the terms of their trust the Commissioners could not object, however useless or even vicious they may have considered the charity, sometimes the provisions of a trust were stretched beyond the limits of legality.¹⁹

The Commission employed legal staff to travel England categorising and investigating all charities, making regular reports on abuses and schemes to reform charitable trusts. The Attorney-General and the judiciary had been largely circumvented by a specialist administrative agency that actively pursued its mission with fairly adequate resources. As a result of the Commission's work, the *Charitable Trusts Act* of 1853²⁰ was enacted. This Act was amended in 1855²¹ and 1860²² to establish a permanent Commission to supervise charitable activity. This Commission still exists, although in recent years it has been reshaped and is currently being reorganised as the result of a sector wide review by government.²³ Again, Australia has failed to adopt the Charity Commission model and relies on Attorneys-General in each state jurisdiction. Two recent inquiries have drawn the federal government's attention to the lack of a Charity Commission style regulator.²⁴ Despite being widely backed by the nonprofit sector, neither has been taken up by government. Although the Australian taxation authorities have played a greater role in charity supervision since 2000, it is a long way from the role played by the American IRS.

Australian Inquiries

One source of information about charitable asset diversions is government inquiries. Compared to the rich vein of public hearings and inquiries in the UK and the US, there have been slim pickings in Australia. Royal Commissions during the 1800s in Victoria,²⁵

¹⁸ Hargraves, *op. cit.*, at p.191.

¹⁹ Owen, D. *English Philanthropy, 1660-1960*, The Belknap Press of Harvard University, Cambridge, Massachusetts, 1964 at p 185.

²⁰ 16 & 17 Vic. c.137.

²¹ 18 & 19 Vic. c.124.

²² 23 & 24 Vic. c.136.

²³ Home Office, *Charities and Not-for-profits: A modern Legal framework: The Government's response to 'Private Action, Public Benefit'*, July 2003, London.

²⁴ Industry Commission, *Charitable Organisations in Australia*, Report No 45, AGPS, Canberra, 1995, at p. 210; Commonwealth of Australia, *Report of the Inquiry into the Definition of Charities and Related Organisations*, June 2001, Canberra, at p. 291.

²⁵ Victoria, *Royal Commission on Charity, 1890*, Final Report dated 22 December 1891, Parliamentary Papers, 1891, Vol.6.

New South Wales,²⁶ Tasmania²⁷ and Queensland²⁸ were not concerned about the regulation of charities by the state, but rather about their level of welfare provision.²⁹ Kennedy concludes that colonial Victoria suffered most from "the complaints endemic to competitive charity in England, apart perhaps from the tangled growth of endowed charities".³⁰ That the vast majority of funds for such charities were derived from the government, not public donors, perhaps explains the lack of interest in private charity and therefore regulation.³¹

Even the contemporary Australian federal governmental inquiries into welfare have made little if any reference to the regulation of charities and have been more interested in the accountability of government funding to voluntary organisations than structural reform of charities or their regulatory environment.³²

The states have not had inquiries of any note, except Victoria. Over three decades from the 1960s, the state of Victoria had a series of public inquiries which touched on the issue. In 1965,³³ the Victorian Chief Justice's Law Reform Committee examined charitable trusts. This review was prompted by the Nathan Report and the adoption of the *Charities Act* 1960 (U.K.).³⁴ In Victoria, it was the Attorney-General who was responsible for the supervision of charitable trusts. The Committee candidly stated that,

²⁶ New South Wales, Select Committee into the Benevolent Asylum, New South Wales Legislative Assembly Votes and Proceedings, Vol.2, 1861-2; New South Wales, Royal Commission on Public Charities, Votes and Proceedings, Second Session, Vol.3, 1898.

²⁷ Tasmania, Royal Commission on Charitable Institutions, Tasmanian Legislative Council Parliamentary Paper, No.47 of 1871.

²⁸ Queensland, Select Committee on Hospitals in the Colony, Legislative Assembly Votes and Proceedings, Vol.1, 1866; Queensland, Select Committee on the Management of the Dunwich Benevolent Asylum, Legislative Assembly Votes and Proceedings, Vol.1, Part 2, 1884.

²⁹ The commissioners concerned themselves with such detail as introducing female nursing staff and sanitary conditions at hospitals and their location, rather than tracking down dormant funds or redirecting charitable trusts.

³⁰ Kennedy, R., "Charity and Ideology in Colonial Victoria", in R. Kennedy (ed), *Australian Welfare History: Critical Essays*, MacMillan: Melbourne, 1982, at p.70.

³¹ Kennedy, *op. cit.*, at p.68.

³² For example, commissions such as Commonwealth of Australia, Commission of Inquiry into Poverty, Australian Government Printing Service, Canberra, 1976; Commonwealth of Australia, Royal Commission on Australian Government Administration, Welfare-Health Task Group Report, Australian Government Printing Service, Canberra, 1976; Commonwealth of Australia, Through a Glass Darkly: Evaluation in Australian Health and Welfare Services, Vol.1, Senate Standing Committee on Social Welfare, Australian Government Printing Service, Canberra, 1979.

³³ Victoria, Chief Justice's Law Reform Committee, Report on Charitable Trusts, Melbourne, 1965.

³⁴ *Ibid.*, at p.1, "and in our report we have to consider whether we should adopt the provision of that Act The *Charities Act* 1960 (U.K.) or some of them."

The Attorney-General has many other duties and cannot with the staff at his command undertake the general supervision of charitable trusts. In practice he has made inquiries only in cases where some matter requiring his intervention is brought to his notice. There is therefore in practice no general supervision over the administration of such trusts. [...] the Attorney-General under the present state of affairs simply cannot possibly undertake an investigation of them.³⁵

To address such a state of affairs, the Committee recommended that there be compulsory registration of charitable trusts.³⁶ This registry was seen as a more modest English Charity Commission that would act to inform the public as to the activities of charitable trusts as well as provide administrative scrutiny and advice to the Attorney-General.³⁷ The Victorian Chief Justice's Committee also noted the now familiar problems of failed charities and legislation was enacted which closely followed that of the English Nathan Committee.³⁸ Similar provisions were adopted in Queensland and South Australia.³⁹

In 1980, the Victorian state government established an interdepartmental working party to report on the administration of charities.⁴⁰ The *Hospitals and Charity Act 1958* (Vic.) had provided a scheme of regulation and scrutiny of welfare service providing charities in Victoria.⁴¹ The Act required every institution and benevolent society to be registered and no institution or benevolent society could be established without the consent of the Health Commission that administered the Act. An academic study inspired by the inquiry found for the year 1978 that less than twenty-three per cent of unsubsidised charities had lodged annual reports and returns. Thirty-six per cent of subsidised charities were found to have lodged such returns. A further survey of the same registry was attempted some five years later.⁴² It found that less than forty-four per cent of the charities had lodged annual returns and reports for the year 1983.⁴³

³⁵ *Ibid.*, at p.15.

³⁶ *Ibid.*, at p.12.

³⁷ *Ibid.*, at p.8.

³⁸ *Ibid.*, at p.22 and section 2 of the *Charities Act 1978* (Vic.).

³⁹ Qld. *Trusts Act 1973*, section 105(2); S.A. *Trustee Act 1936*, section 69b; Vic. *Charities Act 1978*, section 2.

⁴⁰ Victoria, State Government Interdepartmental Working Party, Administration of Charities (First Report), Melbourne, 1980, fourth term of reference, at p.17.

⁴¹ Based on the *Hospitals and Charitable Institutions Act 1864* (Vic.) and the *Hospitals and Charity Act 1922* (Vic.).

⁴² McGillivray, M., C.A. Romano & D.J. Williams, "Regulating the Accountability of Charitable Organisations: The Victorian Experience", *Australian Journal of Public Administration*, 44(3), 1987, pp.307-317.

⁴³ *Ibid.*, at p.315.

Mentioning the study was assiduously avoided by the Working Party who considered that the then proposed incorporated associations legislation would better provide supervision of such charities.⁴⁴ As the Health Department responsibility had grown out of its historical supervision of ancillary welfare services and the distribution of state run lottery proceeds to fund these services, it was eager to shed responsibility for the charity register. A second report by the Working Party was prepared after the introduction of the *Victorian Associations Incorporation Act 1981* recommending that charity supervision could be adequately maintained under that Act and by the traditional supervisory role of the Attorney-General.⁴⁵

Finally, in 1985, the Victorian Health Department in another review of the *Hospitals and Charities Act 1958* convinced the government to excise regulation of charities from their responsibilities.⁴⁶ The unit's recommendations resulted in a new Act, the *Health Services Act 1985*, which did not carry on the regulation of community organisations. They reported that,

The Review Unit believes that current law in this regard is excessively regulatory and largely unnecessary in the light of recent developments in the law.⁴⁷

It was reasoned that the provisions of the Act were not enforced or complied with as the Government had funded most of the social welfare delivery and had its own mechanisms for accountability. Further, members of the public ought to be able to make up their own minds about "what they do with their money."⁴⁸ The Review Unit concluded that other legislation provided an adequate framework for the accountability of charities which would safeguard the public interest.

A comprehensive review of charity regulation in Australia was conducted by the Legal and Constitutional Committee of the Victorian Parliament. In 1988, it was given terms of reference to inquire into the law relating to charitable trusts.⁴⁹ The terms of reference of the Parliamentary Committee were to advise on: the "desirability of revising and simplifying the law relating to charitable trusts"; simplification of "the role performed by

⁴⁴ *Ibid.*, at p.18.

⁴⁵ Victoria, Administration for Charities, Victorian State Government Interdepartmental Working Party, 2nd Report, Victorian Government Printer, Melbourne, 31 March 1982 at p.69.

⁴⁶ Victoria, Regulation of Health Care Agencies and Charities, Health Department, (Discussion Paper No. 8), Melbourne, 1987.

⁴⁷ *Ibid.*, at p.6.

⁴⁸ *Ibid.*, at p.7.

⁴⁹ Victoria, Report on the Law Relating to Charitable Trusts, Legal and Constitutional Committee, 34th report to Victorian Legislative Council, May 1989.

the Supreme Court and the Attorney-General"; and the possibility of the restatement "of the law in a single statute".⁵⁰ As Victoria then had eighty percent of the charitable trusts in Australia, this was an important report.⁵¹

Again, the Committee found that there were practical problems with the Victorian Attorney-General acting as protector of charities due to a lack of resources and an identifiable officer or point of contact.⁵² Investigative procedures had been used twice or three times from 1981-1989,⁵³ and only fifty matters of *cy prés* had been dealt with between 1982-1989.⁵⁴ There were delays of up to two to three years for *cy prés* matters to be processed.⁵⁵ It recommended that the jurisdictional ceiling for small estate schemes administered by the Attorney-General be lifted in value. The revision of the law suggested by the Victorian Chief Justice's Committee concerning *cy prés* was endorsed with only minor suggestions for improvement.⁵⁶

The Committee heard that the current level of regulation was sufficient in the opinion of the "many groups and individuals",⁵⁷ pointing to the remedies available upon a breach of trust, registration through the Australian Taxation Office and the investigatory powers of the Attorney-General. However, the point about the regulatory supervision of the Australian Taxation Office was not very convincing. Professor B.T. Colditz wrote at the end of an examination of Australian charity taxation laws in 1977 that,

It is worthy of mention that there appears to be a remarkable lack of control, or even of public access to information concerning charitable and religious institutions. Although the author has made few direct enquiries his investigations lead him to the view that many exempt-income institutions and funds do not lodge information returns with the taxation authorities, nor of course in the absence of covering legislation would information in respect of such bodies be made available to the public if information returns were lodged.⁵⁸

⁵⁰ Minute of 17 November 1987, of the Victorian Governor in Council.

⁵¹ Report on the Law Relating to Charitable Trusts, p.2.

⁵² *Ibid.*, at p.76.

⁵³ *Ibid.*, at p.77.

⁵⁴ *Ibid.*, at p.78.

⁵⁵ *Ibid.*, at p.60.

⁵⁶ *Ibid.*, at pp.45-57.

⁵⁷ *Ibid.*, at p.94.

⁵⁸ Colditz, B.T., *Income Tax Aspects of the Income of Charities and of Gifts to Charities*, The Taxation Institute of Australia Research and Education Trust:: Sydney, 1977, at p.35.

Sufficient has been said to indicate that for a broad range of charities the Income Tax Assessment Act and regulations provide little control over the activities of organisations, institutions or funds the income of which is exempt or donations to which are allowable deductions. It is understood that in many cases the information returns are not required by the revenue authorities.⁵⁹

The Committee concluded that additional compulsory registration would serve little purpose. In particular, the cost involved in establishing such a registry was perceived to outweigh any potential benefits of increased accessibility to information.⁶⁰ However, they concluded,

While the Committee in fact received no evidence to suggest that there was abuse of the charitable trust mechanism or maladministration by trustees, it is conscious that this does not of itself confirm conclusively that such abuse does not exist.⁶¹

It took note of the potential for abuses and the work of academics on the Victorian Charities register that pointed to a significant regulatory failure.⁶² The Committee recommended that a statutory officer in the Office of the Attorney-General be created to take over the role of the supervision of charities which not only regulated charities but also dispensed advice and training. This had been recommended in the Victorian Chief Justice's Committee's recommendation in 1965, but it was not taken up because it meant extra costs involving the creation of a new bureaucracy.⁶³ The report has not been implemented.

Two recent inquiries have drawn the federal government's attention to the lack of a Charity Commission style regulator.⁶⁴ Despite being widely backed by the nonprofit sector, neither has been taken up by government. Although the Australian taxation authorities have played a greater role in charity supervision, as mentioned previously, their involvement is not at the level of the American IRS. The English schema of a

⁵⁹ *Ibid.*, at p.38.

⁶⁰ *Ibid.*

⁶¹ *Ibid.*, at p.97.

⁶² Williams, D.J. and J. R. Warfe, *The Charities Sector in Victoria - Characteristics and Public Accountability, Accounting and Finance*, May 1982, pp.55-71; McGillivray, Romano & Williams, *op. cit.*, pp.307-317.

⁶³ Williams & Warfe, *op. cit.*, at p.85.

⁶⁴ Industry Commission, *Charitable Organisations in Australia*, Report No 45, AGPS, Canberra, 1995, at p. 210; Commonwealth of Australia, *Report of the Inquiry into the Definition of Charities and Related Organisations*, June 2001, Canberra p 291.

Charity Commission has been entirely absent. Reliance falls entirely to the Attorneys-General as regulators under common law.

Regulation by the Australian Attorneys-General

Australia is reliant on the offices of the Attorneys-General to redress the diversion of charitable assets, there being no other dedicated regulator. It is a traditional function of the English Attorney-General to represent the public interest in litigation. One manifestation of representing the public interest is the representation by relator action of an individual who has no *locus standi* in a particular matter, such as public nuisance,⁶⁵ a criminal act affecting the general public,⁶⁶ statutory authority acting beyond its powers⁶⁷ or enforcing the execution of charitable trusts.⁶⁸

It is theoretically possible for such persons to use the name of the Attorney-General to sue where the Attorney-General gives such permission in what is known as a relator action.⁶⁹ The grant of the Attorney-General's fiat to bring such an action may be *ex officio* or *ex relatione* and it usually will not be granted until all other appropriate steps to resolve the matter have been exhausted.⁷⁰ The Attorney-General may conduct the case, and if this occurs, the relator cannot appear separately or take an opposite view to the Attorney-General. In any case, the costs are borne by the relator.⁷¹ These are severe restrictions on a party's ability to seek a remedy.

Attorneys-General and courts discourage complete strangers to charities bringing relator actions.⁷² The case of *Attorney-General v. Bishop of Worcester*⁷³ provides an illustration of the ancient roots of such views. The case involved a grammar school that was established in 1634 for the benefit of the local inhabitants. The headmaster of the school changed the policy of the school by taking in a greater proportion of boarders and less "free pupils" from the local district.⁷⁴ There was also a nondistribution of books and

⁶⁵ Note (1465) Y.B. Pas. 5 Edw.IV, fo.2, pl.4.

⁶⁶ *Gouriet v. Union of Post Office Workers* [1977] 3 ALL E.R. 70.

⁶⁷ *Weir v. Fermanagh County Council* [1913] 1 I.R. 193.

⁶⁸ *Wallis v. Solicitor General for New Zealand* [1903] A.C. 173 at 181-2.

⁶⁹ *Wylde v. Attorney-General* (1948) 78 C.L.R 224.

⁷⁰ Bradshaw, F.M., *The Law of Charitable Trusts in Australia*, Butterworths: Sydney, 1983 at p.165.

⁷¹ *Attorney-General v. Logan* [1891] 2 QB 100.

⁷² *Southmolton Corporation v. Attorney-General* (1854) 5 HL Cas 1 at 27.

⁷³ *Attorney-General v. Bishop of Worcester* 1851 Hare 368; 68 E.R. 530.

⁷⁴ The point is that a Headmaster usually arranged for boarders to be accommodated at his residence which was supplied by the trust. Boarders paid the Headmaster, not the trust, for the provision of their lodgings and this was a substantial source of income for the Headmaster. By taking more boarders and less local pupils, he aggrieved the residents in limiting the supply of places and was seen to be personally profiting from this policy.

prizes that were part of the trust instrument. As a visitor to the school, the Bishop expressed the opinion that,

Grammar schools [are] not intended for the general education of inhabitants of towns but were exclusively instituted for the purpose of affording the opportunity for a good classical education to the sons of merchants, tradesmen and others evincing an aptitude for learning.⁷⁵

A public meeting of fifteen hundred concerned local residents was held to rectify the situation and modernise the school trust. They made a public appeal for donations to bring a court action through the Attorney-General to enforce the trust deed. At the trial, the judge made the following observation of this activity,

Although no just complaint can be made of the pleadings in the cause, I most highly disapprove of charity informations got up by public meetings and supported by public subscriptions.⁷⁶

There are very few relator actions by Attorneys-General in any Australian jurisdictions. In the Australian states, there has been no relator action in respect of a charity since at least 1980.⁷⁷ The Attorney-General in each Australian state must be a party to legal actions that involve questions concerning the validity of a charitable trust,⁷⁸ where a trustee is seeking directions from the court,⁷⁹ or where there is a dispute between trustees.⁸⁰ The Attorney-General must also give his fiat to any application brought under the various state

⁷⁵ *Attorney-General v. Bishop of Worcester* 1851 Hare 368; 68 E.R. 530 at p.537.

⁷⁶ *Ibid.*, at p.550.

⁷⁷ The Attorney-General's office of each state of Australia and New Zealand was surveyed to ascertain the last relator action. There is no current action and none was revealed when they searched their records back to 1980. M.A. Soper, Crown Counsel for New Zealand, personal communication [letter with author] dated 13 August, 1993; S. Herne, Director of Policy Department of Law, Northern Territory, personal communication [letter with author] dated 17 August 1993; J. Hennessy of NSW Attorney-General's Department, personal communication [telephone discussion] with the author on 10 August, 1993; A. Hall, Assistant Crown Solicitor Environment Section, South Australian Crown Solicitor's Office, personal communication [letter with author] dated 10 August, 1993; Mr R.C. Beazley, Victorian Government Solicitor, personal communication [letter with author] dated 9 November 1993; Mr E. Dreyer, Acting Director, Policy and Legislation Division, Department of Justice and Attorney-General (Qld), personal communication [letter with author] dated 27 August, 1993; Hon. C. Edwards MLA, Attorney-General for Western Australia, personal communication [letter with author] dated 21 September, 1993.

⁷⁸ *Galligan v. Maher* (1902) 19 W.N. (N.S.W.) 299.

⁷⁹ For example clarification as to the extent of activities permitted by the trust deed or variation of the trustee's powers; *National Trustees Executors and Agency Co. of Australasia v. Attorney-General (Vic.)* [1978] V.R. 374.

⁸⁰ *Brooks v. Richardson* [1986] 1 W.L.R. 385.

adaptations of the *Charities Procedure Act 1812*⁸¹ that permits two or more interested petitioners to bring actions against trustees for relief of breaches of trust. This permits only simple breaches of trust to be brought before the court but is rarely used due to restrictive judicial interpretations of the extent of the Act and excessive technicality.⁸²

In England, the power of the Attorney-General has been effectively delegated by the Charities Act to the Charity Commissioners.⁸³ The English Attorney-General performs just a few functions that are initiated by recommendation from the Charity Commission. These include criminal prosecutions of charity-related matters and *cy prés* scheme presentations before the judiciary.⁸⁴

There is little evidence that the Australian Attorneys-General have ever exercised any substantial direct control or scrutiny of charities. Those reported cases concerning the Attorney-General being involved in litigation with charities are almost without exception at the instigation of a private person. Virtually no actions are brought solely by the Attorney-General. Inquiries in England,⁸⁵ Victoria⁸⁶ and New Zealand⁸⁷ noted that very few actions were brought by the Attorney-General against charities. It is characterised as a reactive rather pro-active stance.

On inquiry of Attorneys-General in 1993 by the author, there appeared to be little activity and this has not altered over the last decade. The Northern Territory Attorney-General was not aware of any previous complaints or action concerning a charity⁸⁸; the New South Wales⁸⁹ and South Australian Attorneys-General did not know of any relator action since 1980.⁹⁰ The Victorian Government Solicitor brought one *cy prés* action in the

⁸¹ 52 Geo. III. c. 101; *Imperial Acts Application Act* (No.30 of 1969) (N.S.W.), section 17; *Religious Successory and Charitable Trusts Act 1958* (Vic.), sections 61 and 62; *Trusts Act 1973* (Qld), section 106; *Trustees Act 1962* (S.A.), section 60 ; *Charitable Trusts Act 1962* (W.A.), section 21.

⁸² See the remarks in Bradshaw, *op. cit.*, at p.170-171 and Ford, H.A.J. & W.A. Lee, *Principles of the Law of Trusts*, 2nd ed, The Law Book Company, Sydney, 1990 at 897.

⁸³ *Charities Act 1991* (U.K.), section 6.

⁸⁴ For example section 18 of the *Charity Act 1960* (U.K.).

⁸⁵ United Kingdom, Report of the Committee on the Law and Practice Relating to Charitable Trusts, Cmd. 8710, HMSO, London, 1952, at p.47.

⁸⁶ Victoria, Victorian Legal and Constitutional Committee, A Report to Parliament on The Law Relating to Charitable Trusts, Victorian Government Printer, Melbourne, at p.77.

⁸⁷ New Zealand, Property Law and Equity Reform Committee, Report on The Charitable Trusts Act 1957, Department of Justice, Wellington, 1979 at p.2.

⁸⁸ Herne, S., Director of Policy Department of Law, Northern Territory, personal communication [letter with author] dated 17 August 1993.

⁸⁹ Hennessy, J., of NSW Attorney-General's Department, personal communication [telephone discussion] with the author on 10 August, 1993.

⁹⁰ Hall, A., Assistant Crown Solicitor Environment Section, South Australian Crown Solicitor's Office, personal communication [letter with author] dated 10 August, 1993.

previous five years and no specific officer is responsible for such matters.⁹¹ In Queensland, there are not more than "one or two" *cy prés* applications a year and no remembered relator actions.⁹² In Western Australia, there appears to be greater activity with two *parens patriae* actions in 1993.⁹³ There is no appointed officer to deal with such matters in the Northern Territory, Victoria or Queensland. In South Australia, the officer who was to deal with charity matters was in the Environment Section and wrote,

As you will no doubt infer, the work is somewhat remote from the usual area of legal work conducted by my section.⁹⁴

This situation places enormous responsibility on and faith in charitable trustees to be faithful to the purposes of the charitable trust.

Diversion through frustration of the trust - *Cy prés*

The perpetual nature of charitable trusts brings with it the possibility that some time in the future the purposes of the trust may be frustrated. The law will not allow a charitable trust to fail and will, through the doctrine of *cy prés*, seek to divert the trust to a useful purpose.⁹⁵ There are five possible situations where the authority of the courts must be invoked to facilitate the removal of frustrations arising in charitable trusts and for the assets to be diverted to proper purposes. They are:

- (a) where the proposed terms of the initial settlement of trust property are so indefinite that it can not be applied;
- (b) the immediate failure or impracticability of the named purpose of the trust;
- (c) the later failure of the purpose;
- (d) an immediate surplus of funds to achieve the stated purpose; and

⁹¹ Beazley, R.C., Victorian Government Solicitor, personal communication [letter with author] dated 9 November 1993.

⁹² Dreyer, E., Acting Director, Policy and Legislation Division, Department of Justice and Attorney-General (Qld), personal communication [letter with author] dated 27 August, 1993.

⁹³ Edwards, C. (Hon), MLA, Attorney-General for Western Australia, personal communication [letter with author] dated 21 September, 1993.

⁹⁴ Hall, *op. cit.*, at p.2.

⁹⁵ A term of probable French origins, "cy pre comme", "cy" being this and "pres" being near, near to it; refer L.A. Sheridan & V.T.H. Delany, *The Cy Prés Doctrine*, Sweet & Maxwell Limited: London, 1959, at pp.5-11.

- (e) a subsequent surplus of funds arising from receding purposes or an increase in the funds.

In instances of initial frustration, the court may, in certain circumstances, provide a sanctioned scheme, which deals with the frustration without its lapse. The essence of the scheme is to save a settlement that is frustrated by an initial frustration.⁹⁶ Where an initial or supervening frustrating event occurs, a scheme is devised that will apply the property to another charitable purpose that is as similar as possible to the frustrated charitable intention or purpose.⁹⁷

This function has flowed into the traditions of jurisdictions with an English heritage to varying degrees. There are variations on the body administering a *cy prés* scheme, in England being delegated to the Charity Commission with oversight by the judiciary.⁹⁸ In other jurisdictions, the state represented by the Attorney-General is empowered to supervise the schemes.⁹⁹ In England and Wales, the Charity Commission has concurrent jurisdiction with the court to approve schemes.¹⁰⁰ The powers given to the court and the Charity Commission have been widened to include other circumstances such as permitting amalgamation of charities and funds, dispensing with outdated donor restrictions and modernisation of the areas of benefit and qualifications of beneficiaries.¹⁰¹ The use of such procedures has been criticised as not being effective from an administrative perspective because of the slow, expensive and complicated nature of the process.¹⁰²

Such legislation has found its way into Australian state jurisdictions that are closely modelled on the English Charities Act.¹⁰³ The American colonies rejected the doctrine of *cy prés* outright at first. Fishman gives as reasons for this rejection that the cases of royal prerogative were objectionable to the separation of power principles adopted by the

⁹⁶ Maurice, S.G & D.B. Parker, *Tudor on Charities*, 7th ed., Sweet & Maxwell: London, 1984, at p.215.

⁹⁷ *Ironmongers' Co. v. Attorney-General* (1844) 10 Cl.&F 908.

⁹⁸ *Charities Act* 1992 (U.K.), section 15.

⁹⁹ This is the case in Australia and the United States. For example the *Charitable Funds Act* 1990 (Qld.) section 6.

¹⁰⁰ *Charities Act* 1992 (U.K.), section 13.

¹⁰¹ *Charities Act* 1992 (U.K.), section 15.

¹⁰² Luxton, P., 'Whither *Cy-prés*? An Anglo-American Analysis of Practical Problems', *New Law Journal*, Apr 24, 1987, pp.34-44; Great Britain, *Efficiency Scrutiny of the Supervision of Charity*, Report to the Home Secretary and the Economic Secretary to the Treasury, HMSO, London, 1987, paragraphs 78-95 (known as the Woodfield Report); Great Britain, *Charities: A Framework for the Future*, HMSO, cmd 694, 1989, at pp.33-37.

¹⁰³ *Trusts Act* 1973 (Qld.), section 105, *Charities Act* 1978 (Vic.), sections 2 and 3, *Charitable Trusts Act* 1962 (W.A.), section 7.

colony and meddled with the sanctity of disposal of private property.¹⁰⁴ They were reintroduced at the turn of the century.¹⁰⁵

On inquiry of state Attorneys-General in 1993, there were a handful of *cy prés* applications involving the re distribution of charitable assets.¹⁰⁶ New South Wales had, over the prior ten years, about twenty *cy prés* applications and about a dozen will interpretations a year. The Northern Territory had never been involved in a *cy prés* application and South Australia had only a "handful" of cases at any one time. New Zealand had twenty to thirty *cy prés* cases a year. Victoria, had examined 63 *cy prés* applications in the past five years. Western Australia had six *cy prés* scheme applications in 1993 alone.

Some recent *cy prés* applications do not arouse a great deal of faith in the efficient redeployment of dormant charitable funds. For example, *Re Application by Perpetual Trustees Queensland Ltd* No 4239 of 1999 involved an endowment fund of \$64,000 for charitable purposes. Between 1937 and 1950, there was not a meeting of trustees and, concerning the future of the trust, the judge noted,

Thereafter at various times the incumbent Lord Mayor of Brisbane, officers of the Justice Department, and the present applicant raised questions as to the future management of the trust, the desirability of passing legislation with respect to it, and otherwise debated among themselves the future management of the trust. However, nothing concrete has ever been done.¹⁰⁷

In another recent case, *Re Anzac Cottages Trust*,¹⁰⁸ the trust was a charitable fund established in 1915 to provide housing to war widows. Cottages were gradually sold over the years with funds going into a trust fund. The last sale of a cottage was in 1983. Since then, in excess of \$500,000 sat in an investment account to support the

¹⁰⁴ Fishman, J.J. 'The Development of Nonprofit Corporation Law and an Agenda for Reform', *Emory Law Journal*, Vol.34, 1985, pp.617-683 .

¹⁰⁵ *Ibid.*, at notes 49 and 50.

¹⁰⁶ Refer note 88-93.

¹⁰⁷ Williams J, *Re Application by Perpetual Trustees Queensland Ltd*, No. 4239 of 1999, at para 15.

¹⁰⁸ [2000] QSC 175.

last remaining cottage which the judge described as "although historically and culturally significant, is a modest wooden cottage, badly in need of repair."¹⁰⁹ The matter was finally dealt with in May 2000.

In *Roman Catholic Trusts Corp. for Diocese of Melbourne v Att. Gen. (Vic)*,¹¹⁰ the Roman Catholic Diocese as trustee of a trust applied for a *cy prés* order. A person in 1908 gave the Diocese 90 hectares of land at Shoreham in Victoria in trust for the establishment of an educational farm for orphan boys. A farm was never constructed, but the Christian Brothers erected a dormitory on part of the land as a holiday site. Even this dormitory had fallen into disrepair at the time of the application. Although 92 years had passed, the parties argued that,

It was put on behalf of the Corporation that the trust was never practicable so that, notwithstanding the passage of so many years, this is a case of initial impracticability rather than a supervening impracticability.¹¹¹

The court ordered that the land was to be sold and the proceeds applied for the benefit of disadvantaged children. In any view, over ninety years is a considerable time to reach the conclusion that the trust's purpose was impractical from the start.

Future Challenges

As mentioned at the outset, the lack of transparency of charitable organisations themselves, or through their regulators, makes it difficult to determine the level of fraudulent diversion of charitable assets in Australia. While Australia has its nonprofit scandals from time to time aired in the popular media, it appears to be less common or notable than in the UK or the USA. It is difficult to point to any large diversions of charitable assets by way of fraud or misappropriation or conversions of nonprofit organisations. Wrongdoings by senior executive staff in terms of excessive inurement

¹⁰⁹ *Ibid* at para 12.

¹¹⁰ [2000] VSC 360.

¹¹¹ *Ibid*, a para 5.

are not high on the public agenda. Board members and trustees are in the main, voluntary and unpaid, and sector employees are generally remunerated well below their for-profit or government equivalents.

A combination of factors in the next decade may prompt the parties involved, such as trustees, the Attorney-General and fundraising and taxation regulators, to examine more closely the activities of non-performing charities and trusts. Greater knowledge of the size and nature of the sector combined with the computerisation of register records in taxation and fundraising registries may prompt new examinations. A significant scandal would certainly have an impact on public policy. More likely, is that trends in the nature of Australian society will force charity asset diversion issues on to the public agenda.

There are clearly a number of future challenges for Australia in relation to the proper administration of charitable assets. These are:

- the intra-sector transfer of wealth;
- for-profit conversions; and
- remuneration of board members and senior management.

Intra-sector Transfer of Wealth

The common wisdom is that the growth of charitable giving and particularly foundations in the next decade will come from the transfer of wealth from the baby boomers and migrants.¹¹² This growth may well fuel greater asset diversion that will come to the attention of the public.

There is an even greater intra-sector transfer of wealth that will occur because such baby boomers are no longer capable of managing these assets and no suitable replacement can be arranged. This is particularly so for Australia's declining religious

¹¹² Leat, D. & E. Lethlean, "Trusts and Foundations in Australia", Philanthropy Monograph No. 2, Philanthropy Australia Inc., Melbourne, 2000, at p. 39.

groups. These bodies control substantial health services which may follow the US trend to being converted to for-profit organisations. For-profit conversions are discussed below due to their possible significance. Other diversions may come from charity supervision registries being pushed to take their role more seriously through greater accountability.

In these situations, the present state of regulation and facilitation of such transactions requires attention in order for the redirection of nonprofit capital to be socially useful. In England and Wales over the last three decades, there have been successive administrative modernisations of the process of redirecting assets of charities that have outlived their purposes.¹¹³ In America, the administrative process has been hastily reformed, and in some cases, after the horse has bolted. As mentioned above, Australian jurisdictions are not well served by present *cy prés* arrangements and this will be an important issue for state Attorneys-General in the next decade.

An example of the religious order redeployment is the Sisters of Mercy Congregation in Brisbane. In 1906, the Mater Misericordiae Hospital was established in a rented property in North Quay, Brisbane with six Sisters of Mercy and two lay staff. In 1915, it had a total of 1934 admissions for the year with a wages bill of 318 pounds, representing an average of a penny per week per patient. Today, it is one of the largest hospital complexes in Australia with over 850 beds, including a public hospital, a co-located regional hospital, a university research and training facility, and a total budget of over \$400 million. The Sisters of Mercy also operate a range of schools, disability care facilities, hostels and community centres. Traditionally, the sisters have played a very active role in the staffing and senior management of the institutions and in 1974 over 500 held such positions.

There are presently approximately 300 members of the congregation, with 35 under the age of 55 years. It is expected that in 2010, there will be 3 under that age and, by 2020, there will be one and the majority will be over 85 years. This poses many issues

¹¹³ Picarda, H., *The Law and Practice Relating to Charities*, 3rd ed, Butterworths: London, 1999 refer Part III.

both now and in the immediate future for the congregation. It has established a separate corporation to operate the hospitals with a lay board that reports to the congregation on the restrictive “sponsorship” model, but what will happen when there are no members to report to? How is the essence of the sisters’ mission continued without their presence?

This is typical of the issues faced by other Australian congregations in the order that have over \$600 million in revenue from hospitals alone. Other examples include the Sisters of Charity with over \$575 million, St John of God and the Little Company of Mary. They all are facing a health environment that is particularly turbulent at present with increased pressures on funding and competition. It is not only a concern for Catholic orders, as the Uniting Church in Australia faces declining and aging Church attendees, with 20% over 70 years and nearly one half over 60.¹¹⁴ This is compounded by the younger church attendees having little interest in, commitment to or involvement in the social welfare activities of the Church.¹¹⁵ With half the beds in Australia's non-government hospitals being nonprofit, there is much room for asset diversion.¹¹⁶ One of the options seriously under consideration is the transfer of assets to another nonprofit or for-profit organisation.

Another example is the dissolution of nonprofit clubs and societies populated by baby boomer joiners that have enjoyed tax exemption over the years and received government grants to establish their facilities. Clubs such as lawn bowling clubs are being disbanded. Some are able to alter their constitution to permit the remaining members on dissolution to receive any surplus funds. This has occurred in several lawn bowling clubs and appears to be entirely within the law. However, the question has to be asked, what benefit should the community investment in the way of taxation exemptions, rates rebates, concessional leases of land and government grants also receive from the surplus assets? As our population's interests change even more rapidly, this will be a pressing issue.

¹¹⁴ Hughes, P.J., Religion in Australia, Christian Research Association: Adelaide, 1997, p. 68.

¹¹⁵ Powell, R., "Let Me In, Let Me Out: A Profile of Generation X Church Attendees", Uniting Church Studies, 6(1), March 2000, p 1.

¹¹⁶ ABS, Private Hospitals Australia, Cat. No. 4390.0, 1998, Table 4, p. 15.

For-profit conversions

The most significant challenge for the Australian community is the possible diversion of community welfare assets that are held in charitable trust to be owned or managed by for-profit enterprises. This has been a growing issue in the US over the last decade. In the US, between 1981 and 1995, the percentage of health maintenance organisations dropped from 82% to 29%.¹¹⁷ Hundreds of nonprofit hospitals are being involved in mergers and acquisitions each year. For example, in 1996, there were 768 hospitals involved in 235 mergers and acquisitions.¹¹⁸ Overcapacity resulting from increased competition, technological advances and the desire to reduce dependency on federal funding and create additional sources of capital have been the main causal factors. The same may well happen in the future in Australia.

Until 1997, an estimated ninety foundations with total assets of \$9.3 billion have been created from health care conversions with a median asset size of \$57 million.¹¹⁹ The conversions have been accompanied by American State Attorneys-General litigating to ensure that appropriate consideration is paid for such nonprofit organisations and that the assets were redirected to acceptable purposes. For example, one of California's largest HMOs was bought by its officers and managers for \$108 million. There was an outcry that the deal was at an undervalue. Subsequent litigation arrived at the result that the final payment was \$300 million plus an 80 percent ownership interest in the new for-profit organisation. The proceeds established the Wellness Foundation that has \$1.2 billion in assets.¹²⁰

¹¹⁷ Claxton, G. J. Feder, D. Shactman & S. Altman, "Public Policy Issues in Nonprofit Conversions: An Overview", *Health Affairs*, 16(2), pp 9-28 at p.12

¹¹⁸ Campbell, R.K. "Hospital Collaboration Laws, Anti-trust and State Action Immunity: Will these laws Pass Muster", *Emory Law Journal*, 47(3), 1998, at p 1003.

¹¹⁹ Meyer, H. "A lot is Not Enough: For Foundations Spun Off by Hospital Sales, Even Billions Go Only So Far", *71 Hospital & Health Networks*, 71 (30), 1997, p.30.

¹²⁰ Goddeeris, J.H. & B. Weisbrod, "Conversion from Nonprofit to For-profit Legal Status: Why does it happen and should anyone care?", *Journal of Policy Analysis and Management*, 17(2), 1998, at p. 216.

The literature generated by this nonprofit conversion process is now substantial and beyond the scope of this paper.¹²¹ In the American context, the process has raised a number of concerns such as:

1. the inability of Attorneys-General and courts to adequately protect the public interest because of cumbersome procedures unable to cope with large financial conversions;
2. conflicts of interest by nonprofit board members and senior managers who are also to be officers of the for-profit corporation, where they are given financial incentives or shares;
3. valuation of nonprofit enterprises that is appearing to be an inherently subjective process;
4. lack of disclosure of information concerning the conversion, conducted without meaningful community involvement;
5. financing the conversion through joint venturing and placing an unacceptable amount of risk on the nonprofit institution; and
6. new foundations have been controlled by for-profit interests, not involving the general community. There are concerns about the nature of grants being used for frivolous purposes or to support related for-profit institutions.

Given the aggressive adoption in Australia of the privatisation of government businesses and demutualisation of insurance and financial institutions, it may be that the conditions for conversion of nonprofit institutions to for-profits will soon be upon us. Already, for-profit American health corporations are assessing the Australian health market for rapid acquisition and growth. As similar factors are coming into play in

¹²¹ A summary article is J.J. Fishman, "Checkpoints on the Conversion Highway: Some Trouble Spots in the Conversion of Nonprofit Health Care Organisations to For-Profit Status", *Journal of Corporation Law*, 23 (4) 1998, p 701.

Australia, the large nonprofit health players are starting to plan for this eventuality. Some small nonprofit employment services have already converted from being nonprofit community agencies into for-profit businesses, usually without considering the *cy prés* arrangements in the transfer.

It would have been prudent to have the laws and regulation in place to ensure that the conversion assets are preserved for the benefit of the community as was intended by their donors over many years. Administratively efficient mechanisms that avoid costly Supreme Court litigation that would devour many small funds in legal fees need to be developed to make lazy capital work again in the community's interests.

Board Remuneration

Like the UK, Australian nonprofit boards until recently have been characterized by volunteer board members and eyebrows were sometimes raised even at the reimbursement of expenses for travel and accommodation. However, anecdotal evidence is that board members are beginning to be paid small sums in larger nonprofit boards as a result of the increasing complexity, time commitment, cost of directors' and officers' insurance and the need to attract competent professionals as board members. A recent study by Woodward and Marshall of Australian nonprofit companies found eight percent of respondents were paying non-executive board members.¹²² Of those companies that did not pay their board, 85% did not believe they should be paid any fees in any situation.

Australia does not have any specific legislative provisions that address remuneration of charitable trustees and abuses of the nondistribution constraint through excessive inurement. The court has inherent power to authorize the payment of trustees generally in the absence of a specific power in the trust deed.¹²³ Although the law of fiduciaries would allow the court to review the amount of trustee remuneration, this would require action by the Attorney-General.

¹²² Woodward, S. & S. Marshall, A Better Framework – reforming not-for-profit regulation, Centre for Corporate Law and Securities Regulation, The University of Melbourne, 2004 at p. 111.

¹²³ *Trusts Act 1973 (Qld) s 101*; *Trustee Act 1958 (Vic) s 77*.

The Charity Commission has a policy on trustee remuneration which it has adhered to over the last decade with the occasional case reaching the courts.¹²⁴ The recent UK reforms have set guidelines for the payment of trustees.¹²⁵ The US IRS has extensive provisions to prevent and curtail private inurement in Section 501 (c) (3) or (4) and particularly private benefits in foundations.¹²⁶

If more Australian trustees are being remunerated, the scope for abuse is potentially growing and some agreed standard of behaviour may be warranted given the unknown nature of judicial opinion, due to the lack of cases in the area. Again, with no central regulator such as a Charity Commission and no current interest by the taxation authorities in this issue, it is unlikely that there will be any action until a major scandal erupts.

Conclusion

There is no evidence of large scale diversion of charitable assets in Australia and it would be satisfying to believe that the Australian sector was an example of upright fiduciaries who do little substantial wrong as a group. Such a belief, if true now, is unlikely to be sustained in the coming decade. The growing importance of the sector to the economic life of Australia, increased accountability and the identified future challenges will probably require new regulation to address charitable diversions.

Australia is not well placed to meet these challenges because, although it has adopted the English common law, it has not created the administrative support for these laws such as a Charity Commission. The common law as applied through the Attorney-General or the courts is unlikely to be sufficient to meet the challenge of sustained charitable asset diversion involving illegal activity or for facilitating redeployment of assets to useful purposes. It is clear that a central regulator such as the IRS or a Charity Commission may be required in the future.

¹²⁴ *Smallpiece v AG* [1990] CH. Com. Rep.

¹²⁵ Home Office, Charities and Not-for-profits: A modern Legal framework: The Government's response to 'Private Action, Public Benefit', July 2003, London at para. 5.54ff.

¹²⁶ S 4958 Internal Revenue Code – Intermediate sanction.