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A glimpse down a microscope at spawning a legal fiction

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Most legal systems now provide the means to create entities recognised as a 'juristic person' (borrowing the term from the 'common law' system of Britain and its former colonies) as distinct from 'natural persons', or human beings! Communities around the world vary quite a bit in their appetite to do this, but even canon law has an equivalent: a 'juridic person' or 'public juridic person'. By comparison, an unincorporated partnership (like a legal firm in Dickensian England) remains nothing more than the group of people who make it up.

Such an entity is often referred to as a 'legal fiction' since it has no life but what the law gives it. In turn, that will depend on which bit of law was used to create it and a host of other law that governs some part of what such an entity can do, should do, or must not do.

There is no substitute for legal advice on questions of law. However, board members/directors and other organisational leaders need to be acquainted with some legal concepts in order to appreciate their role and fulfil their governance responsibilities. This paper provides a glimpse of what those should include, so useful to reprise at annual planning days.

Governance documents

Using Australia as an example, these memory-joggers point to documents impacting how an entity exists and things that it can, should, or must not, do:

By the board

Board policies for its own work (sometimes put in the form of a 'charter')

Board delegations of authority, to individuals or groups on the board, or to management

From the "owners"

Constitution (or equivalent), the legal document that gave legal life to the organisation

Documents associated with feedback moments, such as the annual general meeting

State

Legislation that governs:

- incorporating state-based businesses or nonprofit associations
- employing staff
- trade, providing goods and/or services (eg. that they be fit for purpose)
- consumer protection

Commonwealth

Australian Constitution - s109, for example, provides that Commonwealth legislation will prevail over State legislation if an inconsistency arises

Other legislation that governs:

- national corporations
- employing staff (eg. standard provisions on redundancy)
- trade (in relation to trade practices, import/export)
- regulation of competition and consumer protection

The 'owners'

Behind every such entity, there is some group who desires to create it, and over time, determines that it should continue (or not, in which case they may 'close its doors' and cease operation).

As shorthand, we often refer to this group as the 'owners', which is a literal reference in some cases - a commercial entity, whose shareholders are the owners, a strata title body corporate, whose members own some element of the relevant property, or, in a different way, the members of an association, or a mutual/co-operative, or even a religious institute, who are also 'owners' as they somehow collectively own the assets and liabilities of that entity.

The crucial point here is knowing who this group is, because it has the right to say what the entity should do and to what standards it should perform (under the prevailing law). In other words, it is this group with the authority to set the agenda for the board, and the board, in the end, answers to it.

The purposes

In Australia, legislation by the Commonwealth and the various states means that it is difficult to create such an entity unless you say what its purpose is intended to be. This will be set out in, for example, a constitution, articles of association, strata title by-laws, or some equivalent document. The objects can be very broad, but incorporating a company, club, association, or even just a body corporate for strata title units, all require some statement about the reason for which it will exist.

The entity's purposes may be fairly self-evident - a commercial enterprise is there to conduct business, for example, but its board should be fully aware of whether the constituent document limits this in some way - even just to a specific location or a type of business.

That said, however, there is a qualitative understanding to be developed about what the 'owners' think is in or out of scope for the purposes that they agreed: shareholders in an airline might well object to the board starting to deal in tobacco products, for example. A membership organisation's objects are often more qualitative and subjective, and so also benefit from regular review. In every case, there are good moments to refresh the board's shared understanding of these things - during board inductions and in the annual planning cycle, for example.

The board

Again, 'the board' is a label encompassing whatever the relevant equivalent may be - a group of people with the authority to direct an entity subject to the object and purpose expressed by the 'owners'.

Depending on the legal form of the entity, a variety of consequent obligations will arise under the law for its board, but good governance starts earlier: it calls for a commitment to the purposes for which the entity exists, kept fresh by regular revisitation with the 'owners' and in the light of how the entity is performing.