

THE SCOTS' CHURCH BOARD OF MANAGEMENT

Litigation Committee¹ Report

1 June 2018

This report has been approved by the Session for release to the congregation.

Many people have asked about the legal case and now that judgments have been made and put in the public domain, the facts can be presented. The legal action taken by the PCV Trusts Corporation against the Scots' Church Property Trustees ("the Trustees") has had an enormous impact on the Board of Management (BOM) and, indeed, the whole of The Scots' Church.

Our Trustees have two main functions: they "own" the church site and the commercial sites (where the Georges building and the Westpac building presently stand) and they "manage" the letting of the commercial sites. They "own" the land as trustees for the Scots' Church congregation because the congregation itself is a constantly changing group of people. The Trustees' powers and responsibilities are defined in The Scots' Church Properties Trust Deed (SCPTD)².

The SCPTD requires that the Trustees pay 2½% of gross³ rental income from the commercial properties as a commission to the PCV Trusts Corporation (PCVTC). Then, after paying certain specified costs, they must distribute any surplus equally to the PCV for home missions and church extension and to the BOM for church maintenance, mission halls and church offices (and any other purpose approved by the PCV General Assembly).

Background: The main problem related to the legal action was the Scots' Church purchase and renovation of Assembly Hall (AH). It is necessary to understand the sequence of events.

- In 1995, at the PCV Commission of Assembly, the PCVTC (who "owned" Assembly Hall in trust for the PCV) reported, "We believe that the maintenance of Assembly Hall is an excessive drain on the scarce financial resources of the Church. In financial terms, the money spent is never recovered through higher investment return. Moreover, not enough money can be found to properly refurbish the building so that it is an 'advertisement for Presbyterianism'."
- In or about August 2001, the PCVTC obtained two valuation reports on the Assembly Hall. FPD Saville valued it at \$2.79 million, and Jones Lang LaSalle valued it at \$2.8 million.
- At a Scots' Church congregational meeting on 18th November 2001, it was proposed that the church buy Assembly Hall and use part of that for congregational purposes. The Trustees had engaged an architect to inspect Assembly Hall and prepare concept plans showing how the congregational requirements could be provided within Assembly Hall.

At this congregational meeting, the congregation approved an enlargement of the commercial properties to include the site of the congregational hall at 99 Russell St, the outdoor car parking spaces and a strip of land that joined the commercial property along Little Collins St with Collins St. This enlargement would significantly increase the commercial revenue that would flow to the congregation and the PCV. The congregation had an expectation it would receive space for congregational purposes in Assembly Hall.

It must be realised that the congregation GAVE a great deal of very valuable property. Even the walkway from Collins St to the Westpac building enabled the Westpac building to claim a Collins St

¹ The Litigation Committee is a sub-committee of The Scots' Church Board of Management. It comprises Craig McIntosh, Elizabeth Lewis and Douglas Sherman. They were appointed by the Board of Management to interact with DLA Piper, the law firm representing the interests of the Board of Management in the court case between the PCVTC and the Trustees of the Scots Church Properties Trust. Douglas Robertson's assistance is also acknowledged. The Trustees have not been involved with the preparation of this report.

² https://1drv.ms/b/s!AlJhka3GAwCcg_FNDQQvmhJYoAKxrA

³ Less only the costs of collecting that rental

address which has great status and commercial value. The PCV gave nothing: rather they SOLD Assembly Hall to the congregation⁴.

- On 18 December 2001, the General Assembly voted to sell Assembly Hall to The Scots' Church. This sale was conditional on the property developer, APN, paying the Trustees a lease premium⁵ of \$4.5 million for the ground lease of the commercial property. Whilst not the subject of a motion in the General Assembly, the PCV also understood that APN would spend \$1 million in materials and labour for the refurbishment of Assembly Hall.

The Trustees agreed to pay the full lease premium of \$4.5 million for Assembly Hall because it might be considered, as the Honourable Justice Sifris (hereafter denoted Sifris J) subsequently determined, that the lease premium is income to be distributed equally between the PCV and the BOM. In fact, the PCVTC, after receiving the \$4.5 million, paid half this amount to the home missions and church extension arms of the church. This meant that home missions and church extension received the \$2.25 million that they would have received had the lease premium been distributed. Thus the effective amount received by PCVTC Church was only \$2.25 million. However, PCVTC wanted to receive more than this for the AH. The PCVTC was offered a peppercorn lease of the mezzanine floor offices, three car parking spaces, free use of the main auditorium for meetings of the General Assembly and free use of meeting rooms for PCV committees. The PCVTC has benefitted from about 9 years of:

- Free rent, valued, in 2015, at \$65,450 p.a.;
- free car parking, valued, in 2015, at \$27,000 p.a.;
- Free use of the main auditorium for G.A. meetings.
[Full time use of the main auditorium and related areas was valued, in 2015, at \$221,000 p.a.];
- Free use of meeting rooms.

Over and above this is the increase in commercial rent from the new development compared with the rents that were being received from the previous tenants. This increase was made possible by the congregation's surrender of their previous property.

The sale was not a clean sale, because the PCVTC was intended to receive an ongoing commission of 2.5% of all commercial rentals from Assembly Hall, though this lapsed as a consequence of the breach of trust finding.

- On 18 March 2002, the Trustees signed a sales contract with the Presbyterian Church of Victoria to buy Assembly Hall for \$4.5 million.
- In June 2003, the Assembly Hall was inspected by a firm of consulting civil engineers to assess the state of the building. This was a one-day inspection, but it was accompanied by an examination of such drawings of previous work on the building as could be obtained. Many potential repair issues were identified.
- On or about 2006 the property developer took an option to develop the commercial site. This involved the property developer paying a significant annual retainer.
- On or about 7 April 2008, the Trustees signed an agreement with APN, a property developer, to develop the enlarged commercial property. The delay since the end of 2001 had been to enable APN to find a suitable lead tenant for the property.

This agreement resulted in payment of the lease premium, so purchase of AH could proceed.

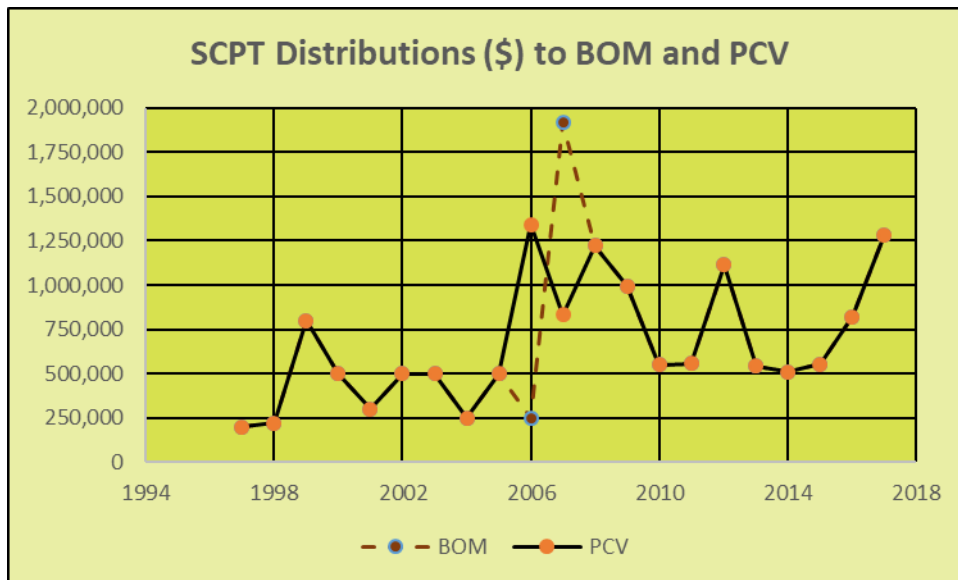
The agreement permitted the church to use a part of the foyer on Sundays, Christmas Day and Good Friday for activities associated with the church. Moreover, it specified that an area on the ground floor of high standard consistent with the finishes of an A Grade office building should be provided.

⁴ The trustees' decision to spend money to refurbish Assembly Hall had an equitable basis. The congregation previously had a working congregational facility at 99 Russell St. Assembly Hall was a rundown building needing major repair before it could be put to congregational use. The poor condition of the building was much better known to the PCVTC than to the trustees. The needed repairs were much more expensive than the \$1 million that had been allowed for.

⁵ A payment for the right to redevelop the land where the Westpac offices now stand (156 Collins Street).

Subsequently, once the needs of Westpac had been defined, this became impracticable and the church was offered an area in lieu on the mezzanine floor, which has not yet been used much.

- The increase in income to the SCPT (and hence to the BOM and the PCV) arising from the development including the congregation's surrender of its hall at 99 Russell St can be seen in the following graph which is based on payments received by the BOM and the PCV over the period shown.



Income to each of BOM and PCV increased from about a quarter of a million dollars per year in the early part of the graph to around one million dollars per year.

Some fluctuations in the graph need to be understood.

- Generally, the BOM and the PCV received equal amounts, so the graphs coincide. However, for some reason there was a phasing difference in 2006 and 2007. In 2006 the PCV received substantially more than the BOM, but in the following year it received less than the BOM by around the same amount. Overall, the two beneficiaries received the same, there was just a time lag for the BOM.
- In 2001, the financial year changed from 30 June to 31 December. Financial reports are available at 30 June 2001, and then for an 18-month period to 31 December 2002. In 2004, the financial year was changed back to 30 June. Thus the 2002 entry is unrepresentatively high and the 2004 entry unrepresentatively low.
- Around 2006 and for a short period thereafter the income was temporarily high because income was still being received from the former tenants in the commercial properties as well as the retainer from the property developer.
- For a period just before and just after 2012, income was reduced because of the Trustees spending on refurbishment of Assembly Hall, later found to be in breach of trust.
- On 7 May 2008, the Trustees signed a lease agreement for the PCVTC offices on the mezzanine floor of Assembly Hall.
- Planning for the refurbishment of Assembly Hall commenced in the first half of 2008, with receipt of a heritage permit at the end of June 2008. There was a grand opening on 2 October 2009, though some refurbishment continued, with the work largely complete at the beginning of 2010.
During refurbishment many hidden problems became apparent and had to be remedied. This necessitated some expensive unforeseen repairs.
- Demolition of 99 Russell St commenced on 30 January 2012.
- On or about 21 June 2013 the Trusts Corporation filed with the Supreme Court of Victoria a statement of claim against the Trustees.
- On 25 June 2014, Sifris J in the Supreme Court of Victoria, at the instigation of the PCVTC, ordered, inter alia, that, "Dr Douglas Sherman be appointed pursuant to rule 16.01 of the rules of court to represent the interests of the members of the Board of Management of the Scots' Church in this

proceeding”. It soon became apparent that this required the BOM to seek independent legal advice on its position. After discussion with Ansvr (the providers of our directors’ and officers’ insurance), the BOM retained DLA Piper as its adviser.

The BOM subsequently formed a litigation committee consisting of Elizabeth Lewis, Craig McIntosh and Douglas Sherman to “give instructions to Douglas Sherman in respect of all aspects of the proceeding”. This committee has also consulted Rev Douglas Robertson, as Chairman of the BOM, as required.

The Breaches of Trust: Sifris J found that the lease premium should have been divided between the PCV and the BOM. Because this had not actually been done, the Trustees were deemed to be in breach of trust.

However, there was a second breach of trust. The Trustees spent approximately \$6.9 million of trust income on the refurbishment of AH. Half this amount should have gone to the PCV and half to the BOM. The trust has no separate source of income, so it was not possible for the trust to pay a financial settlement. The money must either come from the BOM or the Trustees personally.

Sifris J has since delivered four substantive judgments on distinct aspects of the case.

First Judgment: Sifris J determined that the Trustees had no basis for purchasing AH whether under the terms of the Scots’ Church Properties Trust Deed or otherwise. The APN advance should have been distributed to PCV and the BOM as beneficiaries of the Scots’ Church Properties Trust (SCPT). This purchase was a breach of trust.

The Trustees spent money on the refurbishment of AH (i.e. approximately \$6.9 million). This was also a breach of trust. That money should have been distributed between the PCV and the BOM under the terms of the Scots’ Church Properties Trust Deed.

Settlement discussions: Sifris J did not, at that time, rule on the remedy required for these breaches of trust. This effectively gave time for the PCVTC to negotiate this with the BOM to see if a settlement could be reached. Unfortunately, one could not be negotiated.

The PCVTC argued that the AH should be sold to recoup the money lost through breaches of trust. Because of the importance of AH to the ministry of The Scots’ Church, the BOM felt it necessary to employ counsel to present the case for retaining ownership of AH. This came at a very considerable cost: in fact, total spending by the BOM on legal costs is now over half a million dollars. (The PCVTC and the Trustees have each spent many times this amount on their legal proceedings and defence.)

Second judgment: On 7 April 2017, in his second judgment, Sifris J ruled on the consequences of the two breaches of trust. For these breaches of trust Sifris J determined that BOM and PCV had to elect between taking an ownership interest in the AH or a personal remedy against the Trustees.

For the first breach, the PCV had received what it was entitled to i.e. \$2.25m, BOM had not received any distribution. For the second breach, Sifris J ruled that the PCV and BOM each could have an interest in the AH equal to their shares of the renovation costs. Thus if they elected to do so, the PCV should receive a 37% ownership of AH, whilst the BOM would receive the remaining 63% ownership. The BOM and the PCV both elected to take an ownership interest.

In his second judgment, Sifris J was also to consider:

- whether it was invalid for the Trustees to grant the lease of the Mezzanine offices to the PCVTC. The PCVTC voluntarily conceded the lease of the Mezzanine floor should be removed so the judge did not need to decide this.
- the stipends: The Scots’ Church Properties Trust Deed (1891) required the Trustees to pay £1,000 for the salary of the Minister and another £1,000 for the salary of a colleague to the Minister or, if there is no colleague, for congregational purposes. The Trustees formed the view that these sterling amounts should be treated as approximating their present-day value. The PCVTC contended that the stipend amounts were fixed and £1,000 should be interpreted as \$2,000. Sifris J took the view that, given the importance of the role of the Minister, and the fact that the income from Trust had increased dramatically since the Trust Deed was created, it could not have been intended that stipends would be limited to \$2000, the stipends should be interpreted as their current equivalent value. Therefore, he found in favour of the Trustees' views.

Third Judgment: On 26 June 2017, in his third judgment, Sifris J dealt with the final matter raised by the PCVTC. This related to the accounts published by the Trustees. For many years those accounts have been prepared on an accruals basis, but the PCVTC contended that they should be presented on a cash basis and demanded that the accounts for several previous years should be re-done on a cash basis. In 2016 the

Trustees changed to a cash basis, but they preferred to avoid the extra expense of preparing new accounts for the previous years. Sifris J agreed with the Trustees' view.

Fourth Judgment: This judgment referred to the payment of legal costs. It is discussed at the end of this report.

Other matters: There were several other peripheral matters raised in the original Statement of Claim by PCVTC including the proper name of AH, the use of a sinking fund and obedience of the Trustees (to motions of the General Assembly) but none of these matters were ultimately pursued by the PCVTC in Court.

Third Party claim: The Trustees have always contended that they acted under legal advice and consequently brought a counter claim against their external legal adviser. This third-party claim will be considered later in 2018. We understand that, to the extent costs are not recovered from the external legal adviser, Ansvar, the Trustees' directors' and officers' insurer, will seek to recover their costs from the SCPT which means that PCV and the BOM will bear this cost by way of reduced distributions.

Scots' Church Board of Management Limited: On 26 September 2017 Sifris J ordered that, by 4 October, the Trustees transfer ownership of Assembly Hall to the BOM and the PCVTC as tenants in common. The ownership of AH will be vested in the PCVTC (37%) and a trustee for the BOM (63%). It has been decided that the BOM will have a corporate trustee as that will save having to transfer ownership between individuals each time a trustee resigns. A corporate trustee has been set up as a company limited by guarantee called the "Scots' Church Board of Management Limited". The founding directors of this company are Craig McIntosh, Sol Sahhar and Graham Nixon. We are grateful to these three people for taking on this task.

This company will need to agree to arrangements with PCV for joint ownership and management of AH. However, it is not certain what the PCV will do with its 37% share of Assembly Hall. At the 2017 meeting of the General Assembly, the Trusts Corporation presented a report that suggested three options:

1. To retain the 37% in the Assembly Hall and apply the income from that share of the building to home mission and church extension. However, the commercial income generated by Assembly Hall barely covers the day to day running costs of the building. This gives little income for the PCV and any abnormal maintenance would result in a negative return to the PCV.

At present, the PCV and The Scots' Church both occupy significant parts of Assembly Hall free of charge. If they paid a commercial rent, the net income would be improved considerably. However, The Scots' Church cannot afford to pay this rent.

2. Another option is for the PCV to sell its 37% interest in the Assembly Hall to the BOM thus converting the investment into cash. At present the BOM has no funds to buy the PCV share.
3. A third option is to press for the sale of the building itself, with or without the consent of the BOM. This would arise in the absence of any agreement to purchase the PCV's 37% interest. If the BOM was not in agreement it would involve an application to the relevant Tribunal under the Property Law Act 1958 for an order for the sale of the building by the PCVTC as trustee for the home mission and church extension charitable purpose and co-owner.

If the PCV obtained such an order, the BOM would receive its share of the sale price of AH, but we would lose any use of Assembly Hall forever.

Consequences of the Litigation: Until a few years ago, the Building Maintenance and Improvement fund had accumulated a healthy surplus. But in recent years, that surplus has been run down. Most recently the costs of fighting the legal case, together with some other cost over-runs, have consumed the remainder of this surplus and the BOM is now in a position where it must make some significant economies. Recently the BOM has frozen the salaries of all ministers and staff, except for those on minimum salary. All non-essential property repairs and maintenance have been put on hold and costs within the General Fund very closely monitored. However, the maintenance of two large heritage buildings is expensive and some major work will be required soon. We therefore expect the need for further cost-saving measures and/or initiatives in the near future.

The Judge's Summary: The judge dealt with the case in three stages, with a fourth judgment delivered on 27 April 2018, dealing with the apportionment of costs in the case. In this fourth judgment he indicated that, whilst there were faults on both sides, "In the final analysis the position taken by the PCVTC from beginning to end was extravagant, unrealistic, disproportionate, and perhaps opportunistic." (cl 46). In stage 1 the judge found there was a breach of trust, which ultimately resulted in the PCV receiving a 37% ownership of Assembly Hall. However, the judge stated that, "a simple case could have been run dealing with such breach unencumbered by the numerous other allegations that effectively came to nought." (cl 40). The Trustees "won stage 2 and 3. The Court accepted their submissions and there was—following stage 1 and the appropriate concession referred to—no need for Stages 2 and 3." (cl 51).

In his final comments he stated, "I consider and indeed said on many occasions that this was a most unnecessary and undignified dispute. It is in fact shameful. The matter should never have come to Court, particularly given the identity of the litigants. I am almost minded to call for an inquiry into costs. No doubt millions of dollars could have been deployed for charitable purposes. What a waste of considerable time and money. Nobody can escape blame and it is not productive to assign degrees of blameworthiness. I can only yet again encourage the parties to resolve all matters once and for all and not burden the Court of Appeal with matters that are best and only properly dealt with and resolved between the parties, using the Court, if required, in its extensive supervisory jurisdiction."

In the upshot, the Court ordered that, "there will be no order for costs in favour of PCVTC. PCVTC is to pay 50% of the costs of the BOM of the trial of Stage 2 on the standard basis... PCVTC is to pay the costs of the Trustees of the trial of Stages 2 and 3 on the standard basis. The summons by PCVTC addressed to Ansva is dismissed with costs on the standard basis"

Notes

Justice Sifris has, so far, delivered 4 judgments in the main case. These can be downloaded from the internet⁶.

1. <http://www6.austlii.edu.au/cgi-bin/viewdoc/au/cases/vic/VSC/2016/297.html>
2. <http://www6.austlii.edu.au/cgi-bin/viewdoc/au/cases/vic/VSC/2017/102.html>
3. Not available yet
4. <http://www6.austlii.edu.au/cgi-bin/viewdoc/au/cases/vic/VSC/2018/200.html>

⁶ In general, supreme court judgements can be found by searching for "Supreme Court of Victoria Judgements and Sentence", opening the site and clicking on "Trial Division judgements and sentences".