

REGULATING VOLUNTEER DIRECTORS' DUTIES IN COMPANIES REGISTERED WITH THE AUSTRALIAN CHARITIES AND NOT-FOR-PROFITS COMMISSION

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Australian directors, whether volunteering or serving a commercial or charitable company, have similar legal responsibilities and exposure to personal liability for unintentional mistakes. In 1991, the Supreme Court of Victoria awarded \$97 million, equivalent to almost \$200 million today, against a volunteer director of a not-for-profit charitable company. More recently, the Federal Court imposed a \$90,000 penalty on a former Tennis Australia director, Harold Mitchell. Should volunteer charity directors and their fee-earning corporate counterparts be subject to the same legal duties, obligations and liability exposure? This article considers the potential impact of the 2018 Australian Charities and Not-for-profits Commission ('ACNC') Legislation Review Recommendation 11, that the statutory directors' duties in the Corporations Act 2001 (Cth) be turned 'back on' for directors of ACNC registered charitable companies, with specific reference to individual directors, charities, and the regulation of the charity sector. It cautions against regulatory changes that impose unrealistic compliance obligations and complexity that could do significant long-term damage to the sector.

I INTRODUCTION

In Australia, directors, regardless of whether they serve a commercial or charitable company, or whether they are volunteers,¹ have similar legal responsibilities and exposure to personal liability for unintentional mistakes.²

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1 The term 'volunteer director' refers to directors that do not receive any fees for services rendered as board members but may be reimbursed for out-of-pocket expenses: see *Work Health and Safety Act 2011* (Cth) s 4 ('WHS Act').

2 In statutory and general law. Sievers' description captures the indiscriminate application and wide breadth of these duties accurately: 'Directors of all kinds of companies ranging from listed public companies, the directors of which are paid substantial fees, to the voluntary, part-time, unpaid directors of a local sporting

Indeed, the largest ever legal claim in Australia for a breach of directors' duties – \$97 million, equivalent to almost \$200 million today – involved a volunteer director of a not-for-profit or charitable company.³ This begs the question whether directors, serving in the charity sector, volunteering their time and expertise for the public benefit, should be held to the same standards of conduct than their fee-earning corporate counterparts?⁴ Or should volunteer charity directors, whose companies often serve the most vulnerable and disadvantaged sectors of the community,⁵ in a sector that receives significant amounts of public and individual monies,⁶ be held to higher standards of conduct?

The issue of personal liability for corporate fault and what constitutes an 'optimal level of liability'⁷ for directors is longstanding.⁸ Several government bodies reviewed personal liability and corporate law sanctions of commercial

club which happens to be incorporated as a company limited by guarantee': see Sally Sievers, 'The National Safety Council Case' (1991) 9(5) *Company and Securities Law Journal* 338, 338. The statutory provisions regulating officers' duties in terms of occupational health and safety law are an exception – the *WHS Act* (n 1) expressly excludes volunteers at sections 4, 27 and 34. Similar provisions apply in the Australian Capital Territory ('ACT'), New South Wales ('NSW'), the Northern Territory ('NT'), Queensland, South Australia ('SA'), Tasmania and the Commonwealth. In Victoria, section 145(5) of the *Occupational Health and Safety Act 2004* (Vic) excludes volunteers from the definition of 'officer': see Rebecca Best, 'The Effectiveness of the Duty of Officers to Exercise Due Diligence under Section 27 of the *Work Health and Safety Act* in Achieving Good Corporate Governance' (Research Paper, University of Melbourne, 2 October 2013) 11.

- 3 In *Commonwealth Bank of Australia v Eise* (1991) 6 ACSR 1 ('*Eise*'), the Court found that Max Eise, the honorary part-time President of the National Safety Council of Australia ('NSC'), was personally liable to repay some \$97 million owed to the Commonwealth Bank of Australia because Mr Eise did not take reasonable steps to obtain proper financial information. The judgment is discussed in more detail in n 168 and Part V(C)(1). See also Sievers (n 2) 338; Colin A Sharp, 'Centro: Revisiting Old Warnings for NFPs' (2012) 64(6) *Keeping Good Companies* 334, 335.
- 4 An issue Sievers raised in the early nineties: see AS Sievers, 'The Honorary Director: The Obligations of Directors and Committee Members of Non-profit Companies and Associations' (1990) 8(2) *Company and Securities Law Journal* 87, 87; Sievers (n 2) 343; AS Sievers, 'The Liability of Directors and Committee Members of Non-profit Associations in the 1990's' (Working Paper No PONC 7R, Program on Nonprofit Corporations, Queensland University of Technology, 1995) 8.
- 5 See Turnour's comments on how the vulnerability of trust beneficiaries impacts on the trustees' duties: Matthew Turnour, 'Trustee and Directors' Duties: Ensuring Compliance 24/7' (Conference Paper, Fifth Annual Not for Profits and Charities Regulatory Conference, 11–12 May 2017).
- 6 During the 2018 reporting year, government income constituted 47% and donations 7%, in total more than half of ACNC-registered charities' annual revenue: Australian Charities and Not-for-profits Commission, *Australian Charities Report 2018* (Annual Charities Report, 2018) 14.
- 7 Jason Harris, 'Relief from Liability for Company Directors: Recent Developments and Their Implications' (2008) 12 *University of Western Sydney Law Review* 152, 152 ('Relief From Liability for Company Directors').
- 8 For a brief description of the position in 2008, see Neil J Young, 'Has Directors' Liability Gone Too Far or Not Far Enough? A Review of the Standard of Conduct Required of Directors under Sections 180–184 of the *Corporations Act* (Australia)' (2008) 26(4) *Company and Securities Law Journal* 216, 228.

directors in the last four decades.⁹ However, despite the issue being raised,¹⁰ the specific position of volunteer directors has not been investigated in similar depth.¹¹

Tasked with assessing the effectiveness of the provisions and the regulatory framework established by the Australian Charities and Not-for-profits Commission ('ACNC') Acts¹² to achieve their objects,¹³ the 2018 Review of Australian Charities and Not-for-profits Commission Legislation ('ACNC Legislation Review') provided a valuable opportunity to consider and address the standard of conduct expected of volunteer directors of charitable companies in Australia, albeit specifically focusing on companies registered with the ACNC.¹⁴

Many submissions to the Review Panel addressed the legal position of charity directors of companies registered with the ACNC. Several drew attention to the uncertain legal position of such directors after the *Australian Charities and Not-for-profits Commission (Consequential and Transitional) Act 2012* (Cth) ('ACNC Consequential and Transitional Act') amended the *Corporations Act 2001* (Cth) ('Corporations Act') to exclude charitable entities registered with the ACNC from the application of the statutory directors' duties contained in sections 180–3 of the *Corporations Act*.¹⁵ The Review Panel's final report contained three

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- 9 Companies and Securities Law Review Committee, *Company Directors and Officers: Indemnification, Relief and Insurance* (Discussion Paper No 9, April 1989); Senate Standing Committee on Legal and Constitutional Affairs, Parliament of Australia, *Company Directors' Duties* (Report, November 1989); House of Representatives Standing Committee on Legal and Constitutional Affairs, Parliament of Australia, *Corporate Practices and the Rights of Shareholders* (Report, November 1991); Australian Government Treasury, *Directors' Duties and Corporate Governance: Facilitating Innovation and Protecting Investors* (Proposals for Reform Paper No 3, Corporate Law Economic Reform Program, 1997); Corporations and Markets Advisory Committee, *Personal Liability for Corporate Fault* (Report, September 2006); Australian Government Treasury, *Review of Sanctions in Corporate Law* (Discussion Paper, 5 March 2007) <https://web.archive.org/web/20090713002020/http://www.treasury.gov.au/documents/1182/PDF/Review_of_Sanctions.pdf>; Australian Government Treasury, *ASIC Enforcement Review Taskforce Report* (18 December 2017).
- 10 See, eg, Australian Institute of Company Directors, Submission No 42 to Federal Treasury, *Review of Not-for-Profit Governance Arrangements* (27 January 2012); Evidence to Standing Committee on Economics, Parliament of Australia, Canberra, 27 July 2012, 13 (David Gonski).
- 11 Woodward and Marshall highlight that the particular needs of the not-for-profit sector have been overlooked in the company law reform process: Susan Woodward and Shelly Marshall, *A Better Framework: Reforming Not-for-Profit Regulation* (Report, 9 April 2004) 2.
- 12 Together, the *Australian Charities and Not-for-profits Commission Act 2012* (Cth) ('ACNC Act') and the *Australian Charities and Not-for-profits Commission (Consequential and Transitional) Act 2012* (Cth) ('ACNC Consequential and Transitional Act').
- 13 Australian Government Treasury, 'Review of Australian Charities and Not-for-profits Commission (ACNC) Legislation' (Terms of Reference, 20 December 2017) 1.
- 14 The review was conducted to meet the Commonwealth Government's statutory obligation to undertake a review of the *ACNC Act* (n 12) and *ACNC Consequential and Transitional Act* (n 12) after their first five years of operation: *ACNC Consequential and Transitional Act* (n 12) s 16. The report was tabled in Parliament in August 2018.
- 15 Commentaries refer to the exclusion as the 'turning off' of the provisions and duties. Section 111L of the *Corporations Act 2001* (Cth) ('Corporations Act') determines that directors of charitable companies registered with the Australian Charities and Not-for-profits Commission ('ACNC') are not required to comply with certain directors' duties under the *Corporations Act* which are 'switched off' and replaced by the ACNC governance standards. The section, inserted by the *ACNC Consequential and Transitional Act* (n 12) schedule 3 part 3 divisions 1 and 2, contains a list of provisions that do not apply to bodies corporate registered as charities under the *ACNC Act* (n 12), including the directors' duties provisions

recommendations that focused specifically on directors of charitable companies registered with the ACNC:

1. Recommendation 11, that the statutory directors' duties and other provisions contained in the *Corporations Act* be turned 'back on' for charity directors;¹⁶
2. Recommendation 27, that all responsibility for the incorporation and regulation (except for criminal offences) of companies which are registered entities be transferred from the Australian Securities and Investments Commission ('ASIC') to the ACNC;¹⁷ and
3. Recommendation 29, that the interaction of the *Australian Charities and Not-for-profits Commission Act 2012* (Cth) ('ACNC Act') and the *Corporations Act* should be reviewed 'in conjunction with other recommendations dealing with matters related to the interface between' the ACNC Act, the *Australian Charities and Not-for-profits Commission Regulations 2013* (Cth) ('ACNC Regulations') and the *Corporations Act*.¹⁸

The government's response in March 2020 to the ACNC Legislation Review ('Government Response') noted the recommendations related to the *Corporations Act* and acknowledged the importance of legislative clarity and regulatory collaboration. However, it did not support taking immediate action following the panel's recommendations on companies registered with the ACNC.¹⁹ In particular, the government responded to Recommendation 11 that directors' duties and other provisions 'turned off' under the *Corporations Act* since 2013 should be 'turned on' again, with an undertaking to seek the views of the sector on 'the merits and risks of "turning on" the directors' duties under the *Corporations Act* for charitable companies'.²⁰

This article responds to Recommendation 11. It considers the potential consequences of turning the directors' duties contained in sections 180–3 of the *Corporations Act* back on for charity directors. To contextualise the discussion, Part II of the article briefly introduces the charity sector while Part III provides an overview of the charities regulator, the ACNC, and its history. Part IV briefly discusses directors' duties and the legal position of directors of charitable companies in Australia. Against this backdrop, Part V analyses the potential impact of the recommendation on the sector with specific reference to individual directors, charities, and regulation of the sector in general.

under sections 180–3 of the *Corporations Act* (the duties to act with reasonable care and diligence, to act in good faith in the best interests of the company and for a proper purpose, and to not improperly use position or information). The 'turning off' of the directors' duties contained in the *Corporations Act* is discussed in more detail in Part IVA.

16 Australian Government Treasury, *Strengthening for Purpose: Australian Charities and Not-for-profits Commission Legislation Review 2018* (Report, 31 May 2018) 12, 48 ('*Strengthening for Purpose Report*').

17 Ibid 13, 110.

18 Ibid 14, 119.

19 See responses to recommendations 11, 27 and 29 in Australian Government Treasury 'Government Response to the Australian Charities and Not-for-profits Commission Legislation Review 2018' (6 March 2020) 12, 20, 22.

20 Ibid 12.

II THE NOT-FOR-PROFIT SECTOR AND CHARITY SUBSECTOR IN AUSTRALIA²¹

A In Broad Strokes

The not-for-profit sector has been an integral part of Australia's social and economic development since the early days of the colony.²² More recently, it featured prominently in 2019–20 bushfire disaster relief and in providing critical support to affected communities during the COVID-19 pandemic.²³ Most of work of this sector, however, does not feature regularly on leading news stories.

The economic importance of the not-for-profit sector in Australia is widely recognised and well documented.²⁴ The charity sector, in particular, plays a significant role in the Australian economy. The *Australian Charities Report 2018* reflected that charities registered with the ACNC²⁵ employed 1.31 million people during the 2018 reporting year.²⁶ In comparison, manufacturing employed 1.03 million, construction 1.17 million, and education and training 1.36 million people during the same period.²⁷

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- 21 Following the ACNC's description, a not-for-profit organisation is 'an organisation that does not operate for the profit, personal gain or other benefit of particular people': 'Not-for-Profit', *Australian Charities and Not-for-profits Commission* (Web Page) <<https://www.acnc.gov.au/for-charities/start-charity/not-for-profit>>. Charities, a sub-sector of the not-for-profit sector, are not-for-profit entities with 'charitable purposes ... that are for the public benefit': *Charities Act 2013* (Cth) s 5 ('*Charities Act*'). See below n 25.
- 22 Ursula Stephens, 'Reflections on Birthing a Regulator' in Myles McGregor-Lowndes and Bob Wyatt (eds), *Regulating Charities: The Inside Story* (Routledge, 2017) 233, 233.
- 23 Luke Michael, 'How Are Aussie Charities Helping in the Bushfire Crisis?', *ProBono News* (online, 7 January 2020) [1143]–[1148] <<https://probonoaustralia.com.au/news/2020/01/how-are-aussie-charities-helping-in-the-bushfire-crisis/>>; Dominic O'Sullivan, Mubarak Rahamathulla and Manohar Pawar, 'The Impact and Implications of COVID-19: An Australian Perspective' (2020) 2(2) *International Journal of Community and Social Development* 134, 147 <<https://doi.org/10.1177/2516602620937922>>.
- 24 *Strengthening for Purpose Report* (n 16) 16; Ian Murray, 'Regulating Charity in a Federated State: The Australian Perspective' (2018) 9(4) *Nonprofit Policy Forum* 1, 2 <<https://doi.org/10.1515/npf-2018-0034>> ('Regulating Charity in a Federated State'). See also Susan Pascoe, 'The Digital Regulator' in Myles McGregor-Lowndes and Bob Wyatt (eds), *Regulating Charities: The Inside Story* (Routledge, 2017) 211, 212 ('The Digital Regulator').
- 25 Although the *ACNC Act* (n 12) charged the Commissioner with the responsibility to endorse and register not-for-profit entities and established a regulatory framework that can be extended to all not-for-profit entities in the future, initially, and that is still the case, the Commission only registered charities. In terms of section 25-5(1)(b) entities must be charities to be entitled to registration as a type of registered entity. Section 5 of the *Charities Act* (n 21) defines 'a charity' as a not-for-profit entity with charitable purposes that are for the public benefit. Any other non-charitable purposes must be incidental or ancillary to, and in furtherance or in aid of, the primary charitable purposes. Individuals, political parties and or government entities cannot be charities. Susan Pascoe provides a succinct explanation of the concept in Australian law: Pascoe, 'The Digital Regulator' (n 24). Registration with the ACNC is voluntary. However, registration is a prerequisite for access to certain Commonwealth tax concessions: *ACNC Act* (n 12) ss 15-5(3), 20-5(2). Martin and Todd explain charity access to tax concessions: Fiona Martin and Timothy M Todd, 'The Income Tax Exemption of Charities and the Tax Deductibility of Charitable Donations: The United States and Australia Compared' (2018) 33(4) *Australian Tax Forum* 667, 672–3.
- 26 Australian Charities and Not-for-profits Commission, *Australian Charities Report 2018* (n 6) 10. The seventh edition of the report reflects an increase to 1.38 million for 2019: Australian Charities and Not-for-profits Commission, *Australian Charities Report 7th Edition* (Annual Charities Report, 2021) 11.
- 27 Australian Bureau of Statistics, *Jobs: Jobs in Australia* (Catalogue Number 6160.0, 26 October 2021) <<https://www.abs.gov.au/statistics/labour/jobs/jobs-australia/latest-release#data-download>>.

Beyond their economic contribution, charities and the not-for-profit sector make increasingly important social and political contributions, often in response to ever-increasing societal and governmental expectations of the not-for-profit sector's role in delivering public goods.²⁸ Consequently, there has been a significant increase in the degree to which non-government bodies, particularly charities, have been funded by all levels of government to provide human and community services.²⁹

Clearly, not-for-profit organisations and charities engage in almost all aspects of society and form an integral part of Australian society.³⁰ A 2016 report aptly described the sector as the 'glue which holds much of Australian society together and allows it to function and prosper'.³¹

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- 28 John R Butcher, 'An Australian Compact with the Third Sector: Challenges and Prospects' (2011) 17(1) *Third Sector Review* 35, 39; Sue Chapman, 'Foreword' in John R Butcher and David J Gilchrist (eds), *The Three Sector Solution: Delivering Public Policy in Collaboration with Not-for-Profits and Business* (ANU Press, 2016) xxvii-xxxi; David J Gilchrist, 'Partnerships between Government and the Third Sector at a Subnational Level: The Experience of an Australian Subnational Government' in John R Butcher and David J Gilchrist (eds), *The Three Sector Solution: Delivering Public Policy in Collaboration with Not-for-Profits and Business* (ANU Press, 2016) 61; Myles McGregor-Lowndes, 'Lawyers, Reform and Regulation in the Australian Third Sector' (2016) 22(2) *Third Sector Review* 33, 39. In April 2016, the Centre for Social Impact reported that the not-for-profit sector of the social purpose market delivered services to the value of \$78 billion to Australian consumers: Centre for Social Impact, *Australia's Social Purpose Market: Understanding Funding Flows and Exploring Implications* (Report, April 2016) v. During the 2006–07 financial year, not-for-profit income derived from government funding/grants totaled \$25.5 billion (33.5% of the total income): Australian Bureau of Statistics, *Not-for-Profit Organisations, Australia, 2006–07 (Re-Issue)* (Catalogue No 8106.0, 12 June 2009). According to the Centre for Social Impact, government grant funding increased by more than 60% to \$44 billion in 2014: Centre for Social Impact, *Australia's Social Purpose Market: Understanding Funding Flows and Exploring Implications* (Report, April 2016) 14. The 2020 ACNC Report reflected a \$73 billion government income in 2018 for the charity sector only: Australian Charities and Not-for-profits Commission, *Australian Charities Report 2018* (n 6) 15.
- 29 Ian Murray, 'Regulating Charity in a Federated State' (n 24) 2. Butcher argues that it is generally accepted that Australia has 'witnessed an increased reliance by [the] government upon not-for-profit organisations as the preferred agents for the delivery of a wide range of mandated public services': Butcher (n 28) 39. Commonwealth of Australia, Productivity Commission, 'Contribution of the Not-for-Profit Sector' (Research Report, January 2010) 72, reflects government funding to the charity sector for the 2006/07 reporting period as \$25.5 billion. More recently, the ACNC reported government funding of registered charities alone as \$68 billion in 2017, \$61.3 billion in 2016, \$55.7 billion in 2015 and \$42.0 billion in 2014: Australian Charities and Not-for-profits Commission, *Australian Charities Report 2017* (Annual Charities Report, 20 May 2019) 52–4 <<https://www.acnc.gov.au/tools/reports/australian-charities-report-2017>>. According to the *Australian Charities Report 7th Edition* (n 26), government remains a significant revenue source for the sector, with government (including grants) providing 47% of the sector's revenue during the 2019 reporting year: at 17.
- 30 Including health, social services, human rights, disability, the arts and law and advocacy, to name but a few. See 'Contribution of the Not-for-Profit Sector' (n 29) 2; *Strengthening for Purpose Report* (n 16) 8. See also Susan Pascoe, 'Regulating the Not-for-Profit Sector' (Research Paper, State Services Authority, January 2008) 5.
- 31 John McLeod, *The Cause Report: 20 Years of (R)Evolution in the Not for Profit Sector* (Report, April 2016) 5. Mark Lyons argues that the sector is as important a part of a well-functioning society as government and business: Mark Lyons, 'The Legal and Regulatory Environment of the Third Sector' (2003) 25(1) *Asian Journal of Public Administration* 87, 88 <<https://doi.org/10.1080/02598272.2003.10800410>>; Murray, 'Regulating Charity in a Federated State' (n 24) 1, 2; on the importance of the charity sector in Australia, see FH McKay and R Lindberg, 'The Important Role of Charity in the Welfare System for Those Who Are Food Insecure' (2019) 43(4) *Australian and New Zealand Journal of Public Health* 310–12 <<https://doi.org/10.1111/1753-6405.12916>>.

B Charitable Companies and the Charity Sector

The not-for-profit sector is highly diverse. Entities vary in size, type of activity and primary purpose, ranging from very small sporting clubs to significant national, and even multinational organisations.³² The Productivity Commission reported in 2010 that the total not-for-profit sector comprised around 600,000 organisations, with an estimated 440,000 of these identified as small, unincorporated, volunteer-based and generally without legal status.³³

The Australian Taxation Office distinguishes charities as a distinct type of not-for-profit organisation.³⁴ Since 2012, the charity sub-sector has, in the main, been regulated by the ACNC.³⁵ The charity sub-sector is no less diverse than the broader not-for-profit sector. A non-exhaustive list would include large and small welfare organisations, universities, arts organisations, environmental organisations, large religious organisations and small community churches, charitable trusts and foundations, hospitals, and aged care providers.³⁶

Many charities choose to form companies, traditionally regulated by the *Corporations Act*.³⁷ Ramsay and Webster identified companies incorporated under the *Corporations Act* as one of the most common types of charities,³⁸ reporting that, at 9 August 2016, 7,422 entities registered with the ACNC were companies, of which 6,760 were limited by guarantee.³⁹

32 McLeod (n 31) 5; David J Gilchrist and John R Butcher, 'Introduction' in John R Butcher and David J Gilchrist (eds), *The Three Sector Solution: Delivering Public Policy in Collaboration with Not-for-Profits and Business* (ANU Press, 2016) 3; Pascoe, 'The Digital Regulator' (n 24) 212.

33 'Contribution of the Not-for-Profit Sector' (n 29) xxvi.

34 'Types of NFP Organisations', *Australian Taxation Office* (Web Page, 4 September 2020) <<https://www.ato.gov.au/general/aboriginal-and-torres-strait-islander-people/not-for-profit-organisations/types-of-nfp-organisations/>>.

35 Vivienne Brand, Jeff Fitzpatrick and Sulette Lombard, 'Governance and Not-for-Profits: Regulatory Reform' (2013) 15(2) *Flinders Law Journal* 381, 382. It is also important to note that although the name of the *ACNC Act* (n 12) indicates regulation of the broader not-for-profit sector, the reach of ACNC regulation is restricted to registered charities at the moment: see above n 25.

36 Krystian Seibert, 'Navigating Reform in Contested Spaces: Reflections on Not-for-Profit Sector Regulatory Reform in Australia, 2010–2013' in John R Butcher and David J Gilchrist (eds), *The Three Sector Solution* (ANU Press, 2016) 131, 151 ('Navigating Reform in Contested Spaces').

37 Brand, Fitzpatrick and Lombard (n 35) 383.

38 Ian Ramsay and Miranda Webster, 'Registered Charities and Governance Standard 5: An Evaluation' (2017) 45(2) *Australian Business Law Review* 127, 128.

39 Ibid 137 n 76. In 2016, McLeod estimated that approximately 140,000 of not-for-profit organisations are incorporated associations and around 12,000 are companies limited by guarantee: McLeod (n 31) 6. The 2019–20 Auditor-General Report reported that, as of 3 February 2020, 57,600 charities were registered with the ACNC: Commonwealth Auditor-General, *Regulation of Charities by the Australian Charities and Not-for-profits Commission* (Performance Audit Report No 29, 2020) 7. An informal survey of the Charity Register data available in April 2020 revealed 9,808 entities listed as limited companies: 'ACNC Registered Charities', *Data.gov.au* (Web Page, 4 April 2022) <<https://data.gov.au/data/dataset/acnc-register>>. It should be noted that charities can apply to have some or all their information withheld from the Charity Register. If the ACNC has approved that the information be withheld, it does not appear on the Register or in the public dataset. In addition, section 150(1) of the *Corporations Act* (n 15) provides that certain companies registered under the *ACNC Act* (n 12) are not required to include the word 'Limited' at the end of its name. Consequently, identifying all entities with a company structure using a title filter does not provide an exact result.

C Challenges of the Not-for-Profit Sector

Charities and not-for-profit organisations are under pressure. Financial constraints,⁴⁰ increased competition,⁴¹ changing funding and service models⁴² and an increased compliance burden⁴³ contribute to an increasingly demanding environment for these entities.⁴⁴

Of particular concern is the fact that fewer people volunteer for management and leadership positions.⁴⁵ Research indicates that volunteer directors and officers are feeling increasingly under pressure and vulnerable as they become more visible and

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- 40 Many non-profit organisations ('NPOs') are facing funding cuts and reduction in voluntary donations during the current economic environments. The COVID-19 pandemic exacerbated the sector's financial difficulties: Matilda Boseley, "'Really Struggling': Covid-19 Puts Australian Charities at Risk Just When They Are Needed Most', *The Guardian* (online, 24 May 2020) <<https://www.theguardian.com/business/2020/may/24/really-struggling-covid-19-puts-australian-charities-at-risk-just-when-they-are-needed-most>>.
- 41 Sara Dolnicar, Helen Irvine and Katie Lazarevski, 'Mission or Money? Competitive Challenges Facing Public Sector Nonprofit Organisations in an Institutionalised Environment' (2008) 13(2) *International Journal of Nonprofit and Voluntary Sector Marketing* 107 <<https://doi.org/10.1002/nvsm.311>>.
- 42 Florentine Maier, Michael Meyer and Martin Steinberethner, 'Nonprofit Organizations Becoming Business-Like: A Systematic Review' (2016) 45(1) *Nonprofit and Voluntary Sector Quarterly* 64 <<https://doi.org/10.1177/0899764014561796>>. In principle, adopting a business-oriented approach enables not-for-profit organisations to capture the complexity and difficulty of the environment to meet the needs of society in a more efficient way, but balancing the business strategy and the not-for-profit's mission and value can be challenging.
- 43 In 2013, Kurti argued that the new regulatory regime imposed new reporting protocols that are likely to add to the administrative burdens already borne by not-for-profits and making it harder for them to pursue their work effectively: see Peter Kurti, 'In the Pay of the Piper: Governments, Not-for-Profits, and the Burden of Regulation' [2013] (139) *Issue Analysis* 1. The Australian Competition and Consumer Commission's submission to the 2018 Review Panel indicated that during the *Australian Consumer Law Review* in 2017, a number of stakeholders submitted that inconsistencies and duplication between fundraising and other laws that apply to the sector are a significant regulatory burden: Australian Competition and Consumer Commission, Submission to ACNC Legislation Review Panel, *Review of Australian Charities and Not-for-profits Commission (ACNC) Legislation* (27 February 2018) 1. The 2018 Senate inquiry on charity fundraising in the 21st century recognised that charities are struggling with the burden of complying with fundraising laws across multiple jurisdictions and recommended that the Australian Government commit to working with state and territory governments and the not-for-profit sector to develop a consistent national model for regulating not-for-profit and charitable fundraising activities within a time limit of two years: see Select Committee on Charity Fundraising in the 21st Century, Parliament of Australia, *Report* (14 February 2019) vii.
- 44 Gali Blacher, 'Caution for Australian NFPs as UK Charities "Struggling to Survive"', *Third Sector* (Blog Post, 1 March 2017) <<https://www.thirdsector.com.au/caution-for-australian-nfps-as-uk-charities-struggling/>>; *Strengthening for Purpose Report* (n 16) 8.
- 45 Australian Institute of Company Directors, *Not-for-Profit Governance and Performance Study 2019: Key Findings from the 10th Edition* (Report, July 2019) 10; John Chelliah, Martijn Boersma and Alice Klettner, 'Governance Challenges for Not-for-Profit Organisations: Empirical Evidence in Support of a Contingency Approach' (2016) 12(1) *Contemporary Management Research* 3, 12 <<https://doi.org/10.7903/cmr.14538>> ('Governance Challenges'); Ministerial Council for Volunteers, *Volunteers in Victoria: Trends, Challenges and Opportunities* (Report, June 2017) 21; Melinda Maria Varhegyi and Denise Mary Jepsen, 'Director Succession Planning in Not-for-Profit Boards' (2017) 55(1) *Asia Pacific Journal of Human Resources* 106 <<https://doi.org/10.1111/1744-7941.12101>>; Marion Cornish, 'The Appointment of Non-executive Directors in Non-Profit Organisations in Australia' (Masters of Commerce (Honours) Thesis, University of Western Sydney, 2009) 69; Susan J Ellis, 'Where Are Your Volunteer Leaders?' (2012) 30(6) *Nonprofit World* 20; Christel Lorraine Mex, 'Stepping Up or Stepping Out? Recruitment and Retention of Volunteer Leaders in Grassroots Associations' (2018) 24(1) *Third Sector Review* 71.

potentially personally liable for their actions.⁴⁶ The oversight of compliance with the law and risk management,⁴⁷ as well as public accountability and greater transparency are integral to the board's role.⁴⁸ As volunteers, charity directors donate their time and expertise. In most instances, time available to work for free is limited. Increased government oversight and compliance duties require board members to devote more time and attention to the entities they lead.⁴⁹ The more demanding board roles become, the more directors' concerns about errors of commission and omission and director accountability increase.⁵⁰ These concerns impact negatively on volunteer participation rates in leadership roles in the not-for-profit sector.⁵¹

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- 46 The concern about legal liability and reputation is an ongoing issue. The Centre for Corporate Public Affairs published a report in 2008 that canvassed 'reviewing the legal entity of [not-for-profits] relating to directors' liability'. The report cited 'inappropriate levels of legal compliance' as a 'current and potential barrier' to company directors' participation on not-for-profit boards: Centre for Corporate Public Affairs, *Relationship Matters: Not-for-Profit Community Organisations and Corporate Community Investment* (Report, 2008) ix, 83. As early as 2004, Woodward and Marshall reported that nearly a third of not-for-profit companies indicated that they experienced difficulty recruiting directors. The paper did not, however, address the issue in more detail: Woodward and Marshall (n 11) 97.
- 47 In *Australian Securities and Investments Commission v Cassimatis* [No 8] (2016) 336 ALR 209, Edelman J found that directors have a legal duty of care to avoid any risks that may foreseeably harm their organisation, including preventing their company from suffering reputational damage or regulatory action by breaking the law. Justice Dowsett imposed a pecuniary fine of \$70,000 on both defendants: *Australian Securities and Investments Commission v Cassimatis* [No 9] [2018] FCA 385.
- 48 Renz highlights how the nature and content of the work of a non-profit leader have changed since the early 2000s, mentioning the challenge of *effectiveness* following the increased demands for not-for-profit organisations to demonstrate and prove performance, results, and accountability as one of the key types of challenges: David O Renz, 'The Future of Nonprofit Leadership and Management' in David O Renz (ed), *The Jossey-Bass Handbook of Nonprofit Leadership and Management* (John Wiley & Sons, 2016) 734–5 <<https://doi.org/10.1002/9781119176558>>.
- 49 Brand, Fitzpatrick and Lombard (n 35) 387. Browning argues that not-for-profit boards are increasingly becoming much more active and involved in the organizational processes of not-for-profit organizations – that 'good governance begins and ends with the board': Julianna Browning, 'Corporate Governance: How Non-Profit Boards Influence Organizational Decisions' in Sabri Boubaker and Duc Khuong Nguyen (eds), *Board Directors and Corporate Social Responsibility* (Palgrave Macmillan, 2012) 82, 85 <<https://doi.org/10.1057/9780230389304>>. Judith Miller-Millesen highlighted that practitioner-oriented literature in the United States ('US') reflected that not-for-profit boards carry an even greater responsibility than corporate boards to ensure adherence to legal standards and ethical norms: Judith L Miller-Millesen, 'Understanding the Behavior of Nonprofit Boards of Directors: A Theory-Based Approach' (2003) 32(4) *Nonprofit and Voluntary Sector Quarterly* 521, 537 <<https://doi.org/10.1177/0899764003257463>>.
- 50 In a corporate context, Cooke reports that risk, including personal liability for non-compliance, is a major concern for directors of ASX200 directors: Saranne Gay Cooke, 'Relationships, Risk and Remuneration: ASX200 Directors' Practice of the ASX Corporate Governance Council Principles' (PhD Thesis, University of New England, 2018) <<https://hdl.handle.net/1959.11/27262>>. Given that the duties set out under *Governance Standard 5* and the equivalent duties in state or territory legislation that apply to office holders of incorporated associations are similar to the duties contained in the *Corporations Act* (n 15), not-for-profit directors and office holders' concern about personal liability is not unfounded. The judgement in *Eise* (n 3) is a case in point. Director liability is discussed in more detail in Part I(V)(A) and I(V)(C) of this article.
- 51 A 2012 survey of not-for-profit directors carried out by Curtin University for the Australian Institute of Company Directors reflected that that 80% of respondents were worried that the ACNC would not reduce red tape, improve financial planning and standards of compliance, or help with recruiting directors: David Gilchrist, *Directors Social Impact Study 2012: Examining the Contribution of Directors to Australia's Not-for-Profit Sector* (Report, 2012) 29 <<https://www.companydirectors.com.au/-/media/resources/director-resource-centre/nfp/directors-social-impact-study-2012.ashx>>. Chelliah, Boersma and Klettner explain that director recruitment is particularly challenging for not-for-profits with membership-based

Competent, capable, and passionate board members are vital to any organisation – they contribute knowledge, skills and relationships.⁵² Accordingly, the legal position of volunteer directors should be reviewed to avoid an undue loss of leadership capacity that will impact on the health of this sector in the future.

The question whether charity directors should be subject to the directors' duties contained in the *Corporations Act* and regulated by ASIC came to a head after the creation of a bespoke charity regulator, the ACNC, offered an alternative. For purposes of this article, it is therefore important to understand the role of the ACNC.

III THE AUSTRALIAN CHARITIES AND NOT-FOR-PROFITS COMMISSION

The ACNC, the national regulator for all charitable and not-for-profit entities (other than those that are government entities), was established in December 2012 when the *ACNC Act* came into effect.⁵³ The *ACNC Act* followed twenty years of inquiries into the legislative, regulatory and policy environment in which Australian not-for-profits operate, including the Industry Commission (Australian Productivity Commission 1995) and Productivity Commission (Australian Productivity Commission 2010) reports, the Charities Definition Inquiry (Commonwealth of Australia 2001), the Senate Committee Report (Commonwealth of Australia 2008), the Henry Tax Review (Commonwealth of Australia 2010) and the Australian Treasury's *Scoping Study for a National Not-for-Profit Regulator*.⁵⁴

board models as the constitution often determines a pool from which the board must be sourced: John Chelliah, Martijn Boersma and Alice Klettner, 'The Role of a National Regulator in Developing Solutions to Governance Challenges in the Not-for-Profit Sector' (2015) 49(6) *Journal of Developing Areas* 449, 450 <<https://doi.org/10.1353/jda.2015.0083>>. The position in the US is discussed in Matthew Baggetta, Hahrie Han and Kenneth T Andrews, 'Leading Associations: How Individual Characteristics and Team Dynamics Generate Committed Leaders' (2013) 78(4) *American Sociological Review* 544 <<https://doi.org/10.1177/0003122413489877>>.

52 See, eg, Caroline Claussen, 'Capacity Building for Governance' (Literature Review, United Way of Calgary and Area, 20 September 2011) 4; Nicola Sharpe, 'Questioning Authority: The Critical Link between Board Power and Process' (2012) 38(1) *Journal of Corporation Law* 1, 3; Gilchrist (n 51) 8.

53 'Governance Challenges' (n 45) 47; Myles McGregor-Lowndes, 'Are We There Yet?' in Ann O'Connell, Matthew Harding and Miranda Stewart (eds), *Not-for-Profit Law: Theoretical and Comparative Perspectives* (Cambridge University Press, 2014) 358, 358 <<https://doi.org/10.1017/CBO9781107282117.021>>.

54 Commonwealth of Australia, Industry Commission, *Charitable Organisations in Australia* (Report, June 1995); Commonwealth of Australia, Productivity Commission, *Contribution of the Not-for-Profit Sector* (Report, February 2010); Commonwealth Treasury, *Inquiry into the Definition of Charities and Related Organisations* (2001); Senate Standing Committee on Economics, Parliament of Australia, *Inquiry into Disclosure Regimes for Charities and Not-for-Profit Organisations* (2008); Commonwealth Treasury, *Scoping Study for a National Not-for-Profit Regulator* (Final Report, April 2011). The contributions of Susan Pascoe, the inaugural commissioner of the ACNC, and Ursula Stephens to *Regulating Charities: The Inside Story*, edited by Myles McGregor-Lowndes and Bob Wyatt, provide invaluable context and insight on how the ACNC came about in Australia: see Pascoe, 'The Digital Regulator' (n 24) 213–18; Stephens (n 22). For an excellent historical perspective, see Mark Lyons, 'The History of Non-Profit Organisations in Australia as a Test of Some Recent Non-Profit Theory' (1993) 4(3) *Voluntas* 301, 307–11 <<https://doi.org/10.1007/BF01398151>>; Brand, Fitzpatrick and Lombard (n 35).

The objects of the *ACNC Act* are to maintain, protect and enhance public trust and confidence in the Australian not-for-profit sector,⁵⁵ to support and sustain a robust, vibrant, independent and innovative Australian not-for-profit sector,⁵⁶ and to simplify and streamline regulation by reducing ‘unnecessary regulatory obligations on the Australian not-for-profit sector’.⁵⁷ These reflect the different interests at play during the drafting process.⁵⁸ Whereas the sector focused on duplicative, burdensome and unclear governance requirements across all Australian jurisdictions and the absence of a single scheme of governance requirements applying across all not-for-profit entities,⁵⁹ the government concentrated on public trust and confidence.⁶⁰ Many submissions to the ACNC Review panel highlighted the tension between the first object (maintaining and increasing public trust) and the third object (streamlining regulation), indicating that it represents a real challenge for the ACNC.⁶¹

Although the ACNC was not established in response to any trust crisis or finance scandal,⁶² the 2011 exposure draft of the ACNC Bill contained only one single statutory object – to ‘promote public trust and confidence in not-for-profit entities that provide public benefits’.⁶³ The sector, having historically enjoyed high levels of trust in Australia,⁶⁴ lobbied extensively to add the word ‘maintain’

55 *ACNC Act* (n 12) s 15-5(1)(a).

56 *Ibid* s 15-5(1)(b).

57 *Ibid* s 15-5(1)(c).

58 Stephens describes the different interests as ‘competing, yet complementary’: Stephens (n 22) 233.

59 The not-for-profit regulatory reform debate regularly mentions governance and governance arrangements in the sector: Brand, Fitzpatrick and Lombard (n 35) 386. See also Doug Cameron, ‘Lack of Accountability, Transparency in Charity Sector a Huge Concern’ [2011] (6) *Viewpoint* 32.

60 Australian Government Treasury, ‘Treasury’s Not-for-Profit Reform Factsheet: Review of Not-for-Profit Governance Arrangements’ (Factsheet, 8 December 2011). The Treasury’s 2011 scoping study cited ‘the growing trend for governments to contract with not-for-profit entities to undertake service delivery’ resulting ‘in a need to improve the simplicity and transparency of regulatory arrangements for the NFP sector’: Australian Government Treasury, ‘Scoping Study for a National Not-for-Profit Regulator’ (Consultation Paper, January 2011) 2 (‘Scoping Study’).

61 The ACNC submission, for example, indicated that it has only been funded to undertake the first object: *Strengthening for Purpose Report* (n 16) 20.

62 The regulatory reform and the ACNC were not imposed on the sector, instead, the sector widely supported and advocated for it. Pascoe describes the ACNC as unique ‘in the level of sustained advocacy and support it garnered from the not-for-profit (NFP) sector’: Pascoe, ‘The Digital Regulator’ (n 24) 211. See also Siebert, ‘Navigating Reform in Contested Spaces’ (n 36) 134; Stephens (n 22) 245–6; Myles McGregor-Lowndes and Bob Wyatt, ‘Introduction’ in Myles McGregor-Lowndes and Bob Wyatt (eds), *Regulating Charities: The Inside Story* (Routledge, 2017) 1, 1.

63 Australian Government Treasury, ‘Exposure Draft: Australian Charities and Not-for-profits Commission Bill 2012’ (Exposure Draft Legislation, December 2011) <<https://treasury.gov.au/consultation/australian-charities-and-not-for-profits-commission-bill>>.

64 A local survey conducted during March 2013, within months of the ACNC commencing work, indicated that Australians already regard charities as trustworthy: Australian Charities and Not-for-profits Commission, *Research Report (2013): Public Trust and Confidence in Australian Charities* (Report No 3592, 8 July 2013) 4 (‘*ACNC Public Trust and Confidence Report 2013*’). In 2012, Australia ranked as the most generous country in the world in the Charities Aid Foundation’s World Giving Index, stating that in a typical month, more than two-thirds of Australians donate money to charity. Australia also held the highest average score between 2008 and 2012: Charities Aid Foundation, *World Giving Index 2012: A Global View of Giving Trends* (Report, Charities Aid Foundation, December 2012) 6.

to the first object.⁶⁵ However, government press releases announcing the reform emphasised the Commission's goal of improving 'governance, transparency and accountability'.⁶⁶ Confirming Australia's longstanding record of public trust, Australia ranked fourth in the Charities Aid Foundation's ('CAF') Ten Year Overview in 2019.⁶⁷ The ACNC's two-year *Public Trust and Confidence* reports in 2013 and 2015 are aligned with the CAF's findings,⁶⁸ reflecting that the majority of respondents assume charities were responsible and honest.⁶⁹

The third objective, reducing the burden of red tape that charities face, was a response to the complicated and inconsistent pre-2012 regulation of the not-for-profit sector.⁷⁰ Prior to the establishment of the ACNC, Australia did not have a regulatory regime that dealt uniformly with not-for-profit organisations. In addition to governance principles in common law and in equity, the Commonwealth, state, territory and local governments regulated different parts of the not-for-profit sector, and each had a different approach to regulating not-for-profit organisations.⁷¹

The introduction of mandatory minimum governance standards – a streamlined single set of compliance obligations for registered charities – was a crucial element of the reform process for charities registered with the ACNC.⁷² Five principle-based

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- 65 Sector representatives also lobbied for the addition of the second and third objects in the Act.
- 66 Brand, Fitzpatrick and Lombard (n 35) 385; Helen Rittelmeyer, 'Independent Charities, Independent Regulators: The Future of Not-for-Profit Regulation' (Issue Analysis No 143, The Centre for Independent Studies, 6 February 2014) 5.
- 67 Charities Aid Foundation, *CAF World Giving Index: Ten Years of Giving Trends* (Report, October 2019) 23.
- 68 Since its inception in 2012, the ACNC has commissioned three studies into public trust and confidence in Australian charities in 2013, 2015 and 2017: *ACNC Public Trust and Confidence Report 2013* (n 64); Australian Charities and Not-for-profits Commission, *Quantitative & Qualitative Report (2015): Public Trust and Confidence in Australian Charities* (Report No 3646, 18 June 2015) ('*ACNC Public Trust and Confidence Report 2015*'); Robyn Rutley and Israel Stephens, *Public Trust and Confidence in Australian Charities 2017: Market Research Report* (October 2017) ('*ACNC Public Trust and Confidence Report 2017*').
- 69 *ACNC Public Trust and Confidence Report 2013* (n 64) 21; *ACNC Public Trust and Confidence Report 2015* (n 68) 40. Ironically, public confidence and trust emerged as a concern in the years after the Commission was established. The *ACNC Public Trust and Confidence Report 2017* (n 68) indicated that public trust and confidence in charities is dwindling; it recorded a 13% decline in public trust and confidence in charities since 2013. The trust level decreased by 7% between 2013 and 2015 and by 6% between 2015 and 2017: at 2. In 2018, the Edelman Trust Barometer (January) reflected a 'distrusted' rating for Australia's non-government organisation ('NGO') sector, which includes charities, for the first time in five years: Tonia E Ries et al, *2018 Edelman Trust Barometer* (Global Report, 21 January 2018) 9. The prevailing thought equates trust to transparency – transparency requires accountability and accountability requires regulation and supervision. Consequently, the diminishing trust levels strengthen the push for increased regulation and supervision of charities.
- 70 The Commonwealth Treasury's 2011 scoping study for a national regulator highlighted the inconsistent nature of the pre-2012 regulatory structure and argued that the consequential regulatory environment imposed an unnecessarily high burden on some not-for-profit organisations while leaving others insufficiently supervised: 'Scoping Study' (n 60), cited in Brand, Fitzpatrick and Lombard (n 35) 383.
- 71 See Marina Nehme, 'Regulation of the Not-for-Profit Sector: Is Another Change Really Needed?' (2014) 39(1) *Alternative Law Journal* 24 <<https://doi.org/10.1177/1037969X1403900107>>; *Strengthening for Purpose Report* (n 16) 44; *Volunteering Australia, State of Volunteering in Australia* (Report, 2012) 10; Seibert, 'Navigating Reform in Contested Spaces' (n 36) 131; Brand, Fitzpatrick and Lombard (n 35) 386.
- 72 The Governance Standards are contained in the *Australian Charities and Not-for-profits Commission Regulations 2013* (Cth) ('*ACNC Regulations*'), made under the *ACNC Act* (n 12). They came into effect on 1 July 2013.

Standards, aimed at increasing the effectiveness and transparency of registered charities, provided a compliance baseline reflecting a minimum set of outcomes that stakeholders can expect when dealing with registered charities. Unfortunately, the Standards were implemented without a clear explanation of their relationship with existing legislation, resulting in an additional layer of compliance responses.

Many submissions to the ACNC Legislative Review criticised the post-2012 regulatory structure for its complexity, inefficiency and for causing an increased compliance burden.⁷³ In 2014, an Ernst & Young report commissioned by the ACNC found that the regulatory burden created by the *ACNC Act* was impacting charities' ability to achieve charitable outcomes.⁷⁴ Charities argued that an undue emphasis on compliance diluted the distinctive charitable and philanthropical essence of the sector, causing organisations to lose focus of their mission and values.⁷⁵

For individual directors, compliance includes the duty to comply with the set of duties linked to their stewardship role in a company. Part IV briefly explains directors' duties in general and discusses the legal position of directors of companies registered with the ACNC.

IV THE DUTIES OF DIRECTORS OF COMPANIES REGISTERED WITH THE ACNC

A Pre-2013: Directors' Duties in General

Prior to the commencement of the *ACNC (Consequential and Transitional) Act*,⁷⁶ the general obligations and duties imposed on directors and company officers of companies incorporated and registered under the *Corporations Act*, including directors of charitable companies, arose under common law, equity, and statute, especially the *Corporations Act*.⁷⁷

These rules do not shed much light on the potential broader governance role of members of charitable companies. The role was investigated in *Lehtimäki v Cooper*,⁷⁸ a 2020 United Kingdom ('UK') decision. In this case, the UK Supreme Court recognised members of companies limited by guarantee as fiduciaries, who have a duty to act in the best interest of the company.⁷⁹ The judgment was handed down in the context of the UK charity framework and it remains to be

73 *Strengthening for Purpose Report* (n 16) 111.

74 Ernst & Young, *Research into Commonwealth Regulatory and Reporting Burdens on the Charity Sector* (Report, 30 September 2014) 45.

75 See, eg, Johan Hvenmark, 'Business as Usual? On Managerialization and the Adoption of the Balanced Scorecard in a Democratically Governed Civil Society Organization' (2013) 35(2) *Administrative Theory and Praxis* 223, 228 <<https://doi.org/10.2753/ATP1084-1806350203>>; Maier, Meyer and Steinbereithner (n 43); Kurti (n 43). Helen Rittelmeyer identified duplication as '[o]ne of the largest and most unnecessary sources of this red-tape burden': Rittelmeyer (n 67) 4.

76 *ACNC Consequential and Transitional Act* (n 12) sch 3 ss 25, 26.

77 Provisions in the company's constitution and specific contract could also create obligations relating to the performance of directors' duties. This discussion focuses on general law (common law and equity) and the statutory provisions contained in the *Corporations Act* (n 15).

78 [2022] AC 155.

79 *Ibid* [89] (Lady Arden JSC).

seen whether it will also influence views on the legal nature of membership of charitable companies and other charitable entities in Australia.⁸⁰

Although a detailed discussion of directors' duties lies beyond the scope of this article, it would be incomplete without a brief introductory explanation that contextualises the comments about Recommendation 11.⁸¹

In Australia, regulation of directors' duties involves a complex interaction between statutory law and general law.⁸² In equity, directors owe fiduciary duties to their company. The fiduciary duties include the duty to act bona fide in the interests of the company and for proper purposes, to avoid conflicts and profits and to retain discretions.⁸³ Under both common law and equity, directors owe a duty to exercise care and diligence in the performance of their functions.⁸⁴

Although the general law duties and the statutory duties, primarily⁸⁵ contained in part 2D.1 of the *Corporations Act*,⁸⁶ overlap significantly, they differ in

80 See also Myles McGregor-Lowndes and Frances M Hannah, 'Lehtimäki and Ors v Cooper [2020] UKSC 33' (ACPNS Legal Case Reports Series No 2020-94, Australian Centre for Philanthropy and Nonprofit Studies, August 2020) <https://eprints.qut.edu.au/203018/1/2020_94_Lehtim_ki_and_others_v_Cooper_2020_UKSC_33.pdf>.

81 Literature abounds with many excellent commentaries on directors' duties in academic journals, theses, book chapters and entire books. See, eg, Rosemary Teele Langford, *Directors' Duties: Principles and Application* (Federation Press, 1st ed, 2014) ('*Directors' Duties*'); RP Austin, HAJ Ford and IM Ramsay, *Company Directors: Principles of Law and Corporate Governance* (LexisNexis Butterworths, 2005).

82 For a succinct explanation, see Jean J du Plessis, 'A Comparative Analysis of Directors' Duty of Care, Skill and Diligence in South Africa and in Australia' [2010] (1) *Acta Juridica* 263, 271. For a brief explanation of the relationship between case law and legislation, see Philip Lipton, Abe Herzberg and Michelle Welsh, *Understanding Company Law* (Thomson Reuters, 20th ed, 2020) 8 [1.20].

83 *Directors' Duties* (n 81) 8; Jennifer Varzaly, 'The Enforcement of Directors' Duties in Australia: An Empirical Analysis' (2015) 16(2) *European Business Organization Law Review* 281, 290 <<https://doi.org/10.1007/s40804-015-0013-z>>.

84 Jason Harris, Anil Hargovan and Janet Austin, 'Shareholder Primacy Revisited: Does the Public Interest Have Any Role in Statutory Duties? (Australia)' (2008) 26(6) *Company and Securities Law Journal* 355, 359. Executive directors with full-time service contracts will normally be contractually bound to execute their functions with reasonable care: John Lowry, 'The Irreducible Core of the Duty of Care, Skill and Diligence of Company Directors: *Australian Securities and Investments Commission v Healey*' (2012) 75(2) *Modern Law Review* 249, 250–2 <<https://doi.org/10.1111/j.1468-2230.2012.00898.x>>. The article also provides a succinct and informative overview of the development of the duty of care and skill of directors. Langford, Ramsay and Welsh provide a helpful explanation of the foundations of directors' duty of care and skill: Rosemary Teele Langford, Ian Ramsay and Michelle Anne Welsh, 'The Origins of Company Directors' Statutory Duty of Care' (2013) 37(4) *Sydney Law Review* 489.

85 *Corporations Act* (n 15) section 179(1) clearly indicates that part 2D.1 sets out 'some of the most significant duties of directors, secretaries, other officers and employees of corporations' (emphasis added). Importantly, the section also determines that '[o]ther duties are imposed by ... other laws (including the general law)'. Furthermore, section 185(a) provides that sections 180–4 'have effect in addition to, and not in derogation of, any rule of law relating to the duty or liability of a person because of their office or employment in relation to a corporation'. See also Rosemary Teele Langford, 'General Law and Statutory Directors' Duties: "Unmixed Oil and Water" or "Integrated Parts of the Whole Law"?' (2015) 131 *Law Quarterly Review* 635, 636 ('General Law and Statutory Directors' Duties').

86 Harris, 'Relief from Liability for Company Directors' (n 7) 157. See also Kane Loxley, "'Unashamedly More Interventionist" Courts and the Fading Significance of a Director's State of Mind' (2014) 32(7) *Company and Securities Law Journal* 486, 487 about the similarities between the statutory and common law duty of care and skill.

important respects.⁸⁷ General law and statutory duties differ, for example, in scope and application. The general law duties are enforced by the company and aim to protect the company. The statutory duties, enforceable by ASIC, also serve a public protection function and their application extends beyond board directors.⁸⁸ Breaching a statutory duty exposes a director to a compensation order and a range of civil sanctions under the civil penalty regime contained in part 9.4B of the *Corporations Act*.⁸⁹ General law remedies, on the other hand, focus on compensation and damages.⁹⁰ It is important to note, however, that conduct which breaches a statutory duty may also constitute a breach in general law and expose a director to potential liability under the *Corporations Act* as well as in general law.⁹¹

The complex relationship between the general and statutory law regimes compounds the uncertainty surrounding the legal position of charity directors – the *ACNC (Consequential and Transitional) Act* excluded charity directors from the reach of the statutory regime but did not address their position in general law.

The legal position of charity directors following the adoption of the *ACNC (Consequential and Transitional) Act* is discussed below.

B Post-July 2013: The *ACNC (Consequential and Transitional) Act 2012 (Cth)*

The *ACNC (Consequential and Transitional) Act* excluded charitable companies from the application of the statutory duties contained in the *Corporations Act* by inserting section 111L.⁹² The section purported to ‘turn off’ a number of duties

87 *Australian Securities and Investments Commission v Rich* (2009) 236 FLR 1, 128–9 [7192]–[7193] (Austin J).

88 Langford, ‘General Law and Statutory Directors’ Duties’ (n 85) 639; Harris, Hargovan and Austin (n 84) 361. See also Matthew Conaglen’s insightful discussion of the interaction between statutory law and general law: Matthew Conaglen, ‘Interaction between Statutory and General Law Duties Concerning Company Director Conflicts’ (2013) 31(7) *Company and Securities Law Journal* 403, 409–12.

89 Jason Harris, *Company Law: Theories, Principles and Applications* (LexisNexis Butterworths, 2nd ed, 2014) 330–3. Part 9.4B provides for three types of civil penalty orders, including a pecuniary penalty of up to the greater of \$1.11 million (for contraventions post 1 July 2020) or three times the benefit derived, or the detriment avoided because of the contravention. Prior to March 2019, the individual pecuniary penalty was \$200,000 for contraventions of the corporation/scheme civil penalty provisions: *Corporations Act* (n 15) s 1317G(1). See also Lipton, Herzberg and Welsh (n 82) 579. Harris, Hargovan and Austin (n 84) provides an informative discussion of the development of directors’ statutory duties in Australia. It is important to note that a company can apply for a compensation order under section 1317E of the *Corporations Act* in respect of contraventions of civil penalty provisions.

90 Lipton, Herzberg and Welsh (n 82) 570.

91 Sergio Alberto Gramitto Ricci and Jake Miyairi, ‘From Enactment to Mariner: Does the Statutory Business Judgment Rule Change the “Acoustic Separation” between Conduct Rules and Decision Rules in Australia?’ (Conference Paper, Annual Corporate Law Teachers Association Conference, 31 January 2016) 14 <<https://doi.org/10.2139/ssrn.2944111>>; Conaglen (n 88) 411.

92 The statutory duties ‘turned off’ include the duties to act with reasonable care and diligence, to act in good faith in the best interests of the company and for a proper purpose, to not improperly use position or information and the obligations of directors in relation to the disclosure of matters involving material personal interests: *Corporations Act* (n 15) s 111L(1). However, section 588G, the statutory duty to prevent insolvent trading, remains applicable.

and obligations for companies that are registered under the *ACNC Act*,⁹³ to avoid such companies and their directors being subject to both the ACNC governance standards and the duties contained in the *Corporations Act*.⁹⁴

The wording of section 111L, combined with the formulation of Governance Standard 5 which creates a duty for entities rather than individuals, created confusion and resulted in different interpretations of the section. Specifically, it raised the question whether the section excluded charitable companies but not their individual directors. This left the sector uncertain about the statutory duties of charity directors and the consequences following a breach of a duty.⁹⁵ More so, because the statutory amendment did not change charity directors' common law and equitable duties.⁹⁶ Several submissions during the ACNC Legislative Review raised concerns about practical application of directors' duties arising from differences between common law, the *Corporations Act* and the ACNC Governance Standards, illustrating the need to clarify the position of charity directors.⁹⁷

Addressing the uncertainty, the final report of the ACNC Legislation Review recommended in August 2018 that the *Corporations Act* be amended to 'turn on' the duties and other provisions previously 'turned off' by the *ACNC (Consequential and Transitional) Act* for charitable companies and other charitable bodies corporate registered with the ACNC.⁹⁸ The federal government's official response

93 The Explanatory Memorandum to the Australian Charities and Not-for-profits Commission Consequential and Transitional) Bill 2012 explained that the proposed amendments reduced regulatory obligations for not-for-profit organisations by inter alia, eliminating the need for ASIC to continue to regulate not-for-profit entities that are incorporated under the *Corporations Act* (n 15), ensuring fair deductible gift recipient eligibility, and minimising regulatory duplication: Explanatory Memorandum, Australian Charities and Not-for-profits Commission (Consequential and Transitional) Bill 2012 (Cth) [15.49], [15.69], [15.71].

94 In particular, the directors' duties provisions under sections 180–3 of the *Corporations Act* (n 15) (the duties to act with reasonable care and diligence, to act in good faith in the best interests of the company and for a proper purpose, and to not improperly use position or information) and the obligations of directors under sections 191–4 of the *Corporations Act* in relation to the disclosure of matters involving material personal interests were turned off in relation to registered charities when the governance standards came into force: *ACNC Consequential and Transitional Act* (n 12) sch 3 ss 25–6. Section 185, to the extent that it relates to sections 180–3, was also turned off. Turning off the statutory duties provisions also means that directors are not exposed to the related civil penalties contained in part 9.4B of the *Corporations Act*.

95 The application of the governance standards to charities rather than their directors, was raised in many responses to the 2012 Treasury Consultation Paper. See eg, PilchConnect, Submission to the Treasury, *Development of Governance Standards* (15 February 2013); Board Matters, Submission to the Treasury, *Development of Governance Standards* (14 February 2013). Not turning off section 588G (the duty to prevent insolvent trading) and section 184 (imposing criminal liability for reckless or dishonest breaches of the duties under sections 181–3) compounded the confusion. Ramsay and Webster (n 38) provide an in-depth analysis of Governance Standard 5.

96 Ibid. Colin Sharp highlighted the importance and implications of the finding in *ASIC v Healey* (2011) 196 FCR 291 for the not-for-profit sector in a commentary published a few months before the *ACNC Act* came into effect: Sharp (n 3) 336. Given the uncertainty surrounding directors' legal position, Sharp's warning remains pertinent post the adoption of the *ACNC Act* (n 12).

97 Including submissions from ASIC, the Australian Institute of Company Directors, the Law Council of Australia, Justice Connect, the Auditing and Assurance Standards Board, the ACNC itself as well as the Australian Charities and Not-for-profit Commission Advisory Board.

98 See recommendation 11 in *Strengthening for Purpose Report* (n 16) 12.

to the Report, released on 6 March 2020, noted the recommendation, but indicated that it would release a consultation paper seeking the views of the sector on the merits and risks of ‘turning on’ the directors’ duties under the *Corporations Act* for charitable companies.⁹⁹ For now, the legal position remains the same, preserving the uncertainty surrounding the legal position of directors of companies registered with the ACNC.

Part V considers the possible consequences if a decision was made to ‘turn on’ the directors’ duties under the *Corporations Act* for charitable companies.

V THE CONSEQUENCES OF ‘TURNING ON’ SECTIONS 180 TO 183

Recommendation 11 attempted to resolve the uncertainty surrounding the legal position of individual directors of charitable companies.¹⁰⁰ However, the clarity comes at the cost of far-reaching implications for charities, the regulator, and individual directors.

For charities, turning on sections 180 to 183 would mean dual regulation and increased compliance complexity. From a regulatory perspective, it would impact on the regulatory approach and efficacy of the ACNC. For individual directors, it will result in exposure to penalties in excess of \$1 million.¹⁰¹

A For the Charity: Increased Regulative Complexity

Imposing the statutory directors’ duties contained in the *Corporations Act* alongside the Governance Standard 5 would add an additional layer of compliance and regulation to the position prior to December 2012, virtually taking one step forward and two steps back in relation to charitable companies registered with the ACNC.

Before the ACNC legislation came into effect, governance of charitable companies was primarily regulated by one regulator: ASIC.¹⁰² The very purpose of amending the *Corporations Act* was to simplify and avoid duplicative regulation by eliminating the need for ASIC to continue to regulate not-for-profit entities that are incorporated under the *Corporations Act*.¹⁰³ Since July 2013, Governance

99 ‘Government Response to the Australian Charities and Not-for-profits Commission Legislation Review 2018’ (n 19) 12.

100 And related to the issue, members’ remedies where the directors’ duties have been breached. See Ramsay and Webster (n 38) 153.

101 Part V(C) of this article explains the civil penalty regime applicable to directors regulated by the *Corporations Act* (n 15).

102 See Part V(B)(3) of this article.

103 Explanatory Memorandum, Australian Charities and Not-for-profits Commission (Consequential and Transitional) Bill 2012 (Cth) [15.49], explains that the proposed amendments eliminate the need for ASIC to continue to regulate not-for-profit entities that are incorporated under the *Corporations Act* (n 15).

Standard 5 creates a duty, at entity level,¹⁰⁴ that requires charities to 'take reasonable steps to ensure that its responsible entities¹⁰⁵ are subject to, and comply with', the duties under the Standard.¹⁰⁶ Charities' compliance with the duty is supervised by the ACNC.

Turning on the statutory duties would mean that in addition to charities' duties (as an entity) under Governance Standard 5, individual directors, officers and employees (where relevant) would be subject to the provisions in the *Corporations Act*, supervised by a different regulator, ASIC.¹⁰⁷ Although the Governance Standard 5 duties were intended to be 'substantially the same' as the *Corporations Act* duties that were turned off,¹⁰⁸ different wording is used with no mention of general law duties.¹⁰⁹ Consequently, the Governance Standard 5 duties that charities must uphold subject to ACNC supervision, and the duties that individual directors of the same charities are bound to and regulated by ASIC, are different. The difference may be one of nuance, but two parallel sets of compliance structures translate into an untenable regulatory burden.

The impact of regulative duality extends beyond the challenge of compliance with different standards. Supervision by different regulators with different regulatory approaches and policies not only compounds the regulatory burden but also affects regulators' ability to achieve their objectives.¹¹⁰

104 Consistent with the powers in the *ACNC Act* (n 12), Governance Standard 5 obliges charitable companies rather than individual directors to avoid constitutional difficulties: Australian Government Treasury, 'Development of Governance Standards' (Consultation Paper, December 2012) 20–1. For an explanation of the constitutional limitations of the ACNC regulatory framework, see Ramsay and Webster (n 38) 133.

105 The phrase 'responsible entities of a registered entity' denotes the 'responsible people' of that charity. The term entity is explained as 'the word used in the *ACNC Act* (n 12) to describe any kind of 'legal person', including a 'registered charity ('registered entity')': 'Entity', *Australian Charities and Not-for-profits Commission* (Web Page) <<https://www.acnc.gov.au/tools/topic-guides/entity>>. A 'responsible person' is defined as 'someone who is responsible for governing a charity': 'Responsible Persons', *Australian Charities and Not-for-profits Commission* (Web Page) <<https://www.acnc.gov.au/tools/topic-guides/responsible-people>>. It includes directors: *ACNC Act* (n 12) s 205-30(a).

106 *ACNC Regulations* (n 72) reg 45.25(2).

107 *Corporations Act* (n 15) ss 180–3.

108 Australian Government Treasury, 'Development of Governance Standards' (n 104).

109 In particular, Governance Standard 5 includes the duty to 'ensure that the registered entity's financial affairs are managed in a responsible manner': *ACNC Regulations* (n 72) reg 45.25(2)(f), whereas part 2D.1 of the *Corporations Act* (n 15) does not specify such a duty.

110 Ian Murray considered the issue of duplicative regulation in an informative and thoughtful discussion of the regulatory crossover between the Australian Taxation Office and the ACNC. He concluded that duplicative regulation, especially when overarching regulatory goals conflict, could hinder instead of help integrity: Ian Murray, 'Fierce Extremes: Will Tax Endorsement Stymie More Nuanced Enforcement by the Australian Charities and Not-for-profits Commission?' (2013) 15(2) *Journal of Australian Taxation* 233, 256 ('Fierce Extremes'). Similarly, Wishart and Wardrop draw attention to the overlap between the Banking Executive Accountability Regime ('BEAR') obligations and directors' duties in the *Corporations Act* (n 15) and the possible impact on the Australian Prudential Regulation Authority's ('APRA') regulatory style: David Wishart and Ann Wardrop, 'What Can the Banking Royal Commission Achieve: Regulating for Good Corporate Culture?' (2018) 43(2) *Alternative Law Journal* 81, 87 <<https://doi.org/10.1177/1037969X18772153>>.

B For Regulation: Impeding Responsive Regulation in the Charity Sector

Turning on sections 180 to 183 of the *Corporations Act* would constitute a lost opportunity to develop responsive regulation. Instead, it would subject charitable companies to two contrasting and incompatible regulatory approaches, inevitably diluting the positive impact of ACNC's responsive regulatory approach. In order to elaborate on this statement, the next section briefly explains the concept of responsive regulation and explores the regulatory approaches of the ACNC and ASIC with reference to constitutive legislation, regulatory approach statements and case law.

1 'Responsive Regulatory Theory'¹¹¹ and 'Proportional Regulation'?

Responsive regulation is considered one of the most influential developments in regulatory theory during the final decades of the 20th century.¹¹² Reflecting neither a solely deterrent nor a solely cooperative approach, it proposes that an effective, efficient and legitimate regulatory policy avoids a binary perspective.¹¹³ The quest to identify and apply the intervention that is most likely to achieve the desired enforcement or regulatory outcome lies at the heart of responsive regulation.¹¹⁴ According to Braithwaite and Ivec, 'the essence of responsive regulation is listening and adapting in response to the problem we are trying to fix and to the people who can fix it'.¹¹⁵ Responsive regulation provides regulators with a range of practical tools – 'the regulatory pyramid, risk compliance continuums, stick-and-carrot incentives, and co-option of third parties to do some regulatory heavy lifting'.¹¹⁶ Relational and collaborative in nature,¹¹⁷ responsive regulation considers the 'relationship between regulation and those being regulated and offers a graduated

111 Also identified as strategic regulation theory: Vicky Comino, 'The Enforcement Record of ASIC since the Introduction of the Civil Penalty Regime' (2007) 20(2) *Australian Journal of Corporate Law* 183, 188.

112 Victorian Law Reform Commission, *Surveillance in Public Places* (Final Report 18, 1 June 2010) 75 ('*Surveillance in Public Places*'). Ayres and Braithwaite first articulated this theory in their seminal work: Ian Ayres and John Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate* (Oxford University Press, 1992).

113 Vibeke Lehmann Nielsen and Christine Parker, 'Testing Responsive Regulation in Regulatory Enforcement' (2009) 3(4) *Regulation and Governance* 376, 376 <<https://doi.org/10.1111/j.1748-5991.2009.01064.x>>.

114 Braithwaite describes it as 'better ways of solving problems': John Braithwaite, 'The Essence of Responsive Regulation' (2011) 44(3) *University of British Columbia Law Review* 475, 481. Sparrow's harms-based regulatory approach, recognising the importance of tailor-made responses to achieve effective regulation, complements the original enforcement pyramid: Malcolm Sparrow, 'Problem-Oriented Policing: Matching the Science to the Art' (2018) 7(1) *An Interdisciplinary Journal* 1, 2 <<https://doi.org/10.1186/s40163-018-0088-2>>.

115 Mary Ivec and Valerie Braithwaite, 'Applications of Responsive Regulatory Theory in Australia and Overseas: Update' (RegNet Research Paper No 72, Regulatory Institutions Network, Australian National University, 2015) 5 <<https://doi.org/10.2139/ssrn.2586888>>.

116 McGregor-Lowndes and Wyatt, 'Introduction' (n 62) 1, 4.

117 Darryl K K Brown, 'Street Crime, Corporate Crime, and the Contingency of Criminal Liability' (2001) 149(5) *University of Pennsylvania Law Review* 1295, 1305 <<https://doi.org/10.2307/3312963>>. Tomasic identifies it as punishment-based: Roman Tomasic, 'The Challenge of Corporate Law Enforcement: Future Directions for Corporations Law in Australia' (2006) 10 *University of Western Sydney Law Review* 1.

approach to enforcement'.¹¹⁸ The Ayres-Braithwaite enforcement pyramid, introduced in 1992,¹¹⁹ illustrates graduated enforcement: subjecting regulated entities to escalating forms of regulatory intervention.¹²⁰ Following a cooperative, non-confrontational approach, enforcement ranges from dialogue and efforts to coax voluntary responses through to civil sanctions, and criminal prosecution. The Ayres-Braithwaite enforcement pyramid increasingly typifies enforcement practice.¹²¹ In the context of regulating directors' duties, the *Corporations Act* contains various levels of enforcement corresponding to the seriousness of the contravention, ranging from disqualification from management, through monetary fines to incarceration.¹²²

Inherently flexible and responsive, by its very nature dynamic,¹²³ the theory of responsive regulation continually evolves and lends itself to application in different contexts.¹²⁴ A wide range of different regulatory agencies have implemented, adapted and applied responsive regulation in a variety of contexts in the almost three decades since its inception.¹²⁵ Bespoke regulation of directors' duties in the charity sphere affords a valuable opportunity to develop responsive regulation.¹²⁶

2 Proportionality and Responsive Regulation in the ACNC Regulatory Framework

Responsive regulative theory underpins the ACNC regulatory framework. The objects of the Act establish the collaborative and cooperative nature of the regulatory framework created by the Act: 'maintain[ing], protect[ing] and enhanc[ing] public trust and confidence in the Australian not-for-profit sector', 'support[ing] and

118 *Surveillance in Public Places* (n 112) 75; Ayres and Braithwaite (n 112) 35.

119 Ayres and Braithwaite (n 112) 35.

120 *Ibid* 20.

121 Brown (n 117) 1313.

122 *Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Act 2019* (Cth) sch 2 ('*Treasury Laws Amendment Act*'); *Corporations Act* (n 15) pts 9.4B, 2D.6, 5.7B div 3. Vicky Comino provided a detailed analysis of the strategic regulation theory and pyramidal enforcement of directors' duties in Australia: Vicky Comino, 'Theory and Practice: The Australian Securities and Investments Commission and the Regulation of Corporate Misconduct' (PhD Thesis, The University of Queensland, 2011) 108, 208–14. See also Renee M Jones and Michelle Welsh, 'Toward a Public Enforcement Model for Directors' Duty of Oversight' (2012) 45(2) *Vanderbilt Journal of Transnational Law* 343, 372–6. It is important to note that the duty of care and skill is not linked to a criminal penalty: at 379.

123 John Braithwaite, 'Relational Republican Regulation' (2013) 7(1) *Regulation and Governance* 124, 125 <<https://doi.org/10.1111/rego.12004>>.

124 Christine Parker, 'Twenty Years of Responsive Regulation: An Appreciation and Appraisal' (2013) 7(1) *Regulation and Governance* 2, 3 <<https://doi.org/10.1111/rego.12006>>.

125 Braithwaite, 'The Essence of Responsive Regulation' (n 114) 476. Wood et al outlined many examples of responsive regulation applications in Australia and internationally: Charlotte Wood et al, 'Applications of Responsive Regulatory Theory in Australia and Overseas: Update' (Working Paper No 15, Regulatory Institutions Network, Australian National University, June 2010). A 2015 update provided an expanded set of examples: Ivec and Braithwaite (n 115).

126 *Strengthening for Purpose Report* (n 16) specifically recommended that the ACNC maintain its responsive regulatory approach: 'The Panel supports the ACNC continuing to focus on the education and research provision role that has served it so well over the first five years of operation': at 32.

sustain[ing] a robust, vibrant, independent and innovative' sector and 'promot[ing] the reduction of unnecessary regulatory obligations' on the sector.¹²⁷

Division 15-10 of the *ACNC Act* specifically instructs the Commissioner to have regard to the principles of regulatory necessity, reflecting risk and proportionate regulation when exercising their powers and functions.¹²⁸ In addition, the ACNC's Regulatory Approach Statement reiterates the proportionate approach reflected in the objects of the Act, highlighting that it considers a wide range of factors to determine the seriousness of an issue before taking 'appropriate and proportionate action' to address the non-compliance.¹²⁹ Moreover, the ACNC Regulatory Approach Statement cites five key values – 'Fairness, Accountability, Independence, Integrity and Respect' – which the Commissioner must employ in the execution of duties and powers.¹³⁰

The Act also creates different classes of registered entities: small, medium and large.¹³¹ The scaled reporting duties and timeframe to update charity details of large, medium and small charities facilitate proportionality in financial reporting.¹³² Following the Government Response supporting the 2018 Review Panel's recommendations of further diversification in financial reporting issues,

127 *ACNC Act* (n 12) s 15-5; Explanatory Memorandum, Australian Charities and Not-for-profits Commission (Consequential and Transitional) Bill 2012 (Cth) [1.105]. See also Murray, 'Fierce Extremes' (n 110) 233, 237–8; Pascoe, 'The Digital Regulator' (n 24) 216.

128 *ACNC Act* (n 12) s 15-10(e).

129 The Commissioner's Policy Statement on Compliance and Enforcement, explaining these principles and their application in the execution of the Commission's powers and functions in greater detail, highlights the focus on proportionality, stating that 'compliance measures and responses will be proportional to the problem they seek to address' and clearly indicates that the Commission aims 'not to burden charities any more than is reasonably necessary': Australian Charities and Not-for-profits Commission, 'Commissioner's Policy Statement: Compliance and Enforcement' (Policy Statement, CPS 2013/01, 2013) 3 <<https://web.archive.org/web/20190513012231/https://www.acnc.gov.au/sites/default/files/Download%20statement%20on%20Compliance%20and%20enforcement%20%5BPDF%20189KB%5D.pdf>>.

130 'Regulatory Approach Statement', *Australian Charities and Not-for-profits Commission* (Web Page, December 2018) [29] <<https://www.acnc.gov.au/raise-concern/regulating-charities/acnc-regulatory-approach-statement>>.

131 The size of the charity is based on its total annual revenue for the period upon which it is reporting. A registered entity is a 'small' registered entity for a particular financial year if the revenue of the registered entity for the financial year is less than \$250,000, medium if the revenue of the registered entity for the financial year is more than \$250,000 but less than \$1 million, and large if the revenue of the registered entity for the financial year is more than \$1 million: *ACNC Act* (n 12) s 205-25. The 2018 Review Panel recommended that revenue thresholds be increased to less than \$1 million for small charities, from \$1 million to less than \$5 million for medium charities and \$5 million or more for large charities, determined on rolling three-year revenue: see recommendation 12 in *Strengthening for Purpose Report* (n 16) 12.

The recommendation was supported by the government: Australian Government Treasury, 'Government Response to the Australian Charities and Not-for-profits Commission Legislation Review 2018' (n 19) 12.

132 All registered entities must submit an annual information statement whereas medium and large entities must also submit audited annual financial reports: *ACNC Act* (n 12) ss 60-5, 60-10. Section 65-5 requires all registered entities to notify the Commissioner of a change in details. However, small entities must do so within 60 days whereas medium and large must submit change of details within 28 days.

the level of proportionality in financial reporting in the ACNC regulatory structure will increase.¹³³

Another clear example of the responsive nature of the regulatory structure can be found in section 15-10(g). It compels the Commissioner to consider the benefits gained from assisting registered entities in complying with and understanding this Act, by providing them with guidance and education, illustrating the responsive nature of the regulatory structure.¹³⁴ In 2017, the regulator reported a host of innovative ways to deliver information designed to assist charities to understand and fulfil their regulatory obligations.¹³⁵

Confirming the positive impact of the ACNC's regulatory approach on the charity and not-for-profit sector, the ACNC Legislation Review Panel recognised the Commission's functions in education and research as 'highly valuable' and that it 'should continue as a priority'.¹³⁶ The panel found that the ACNC's focus on research, guidance and education has been effective as a form of 'behavioural nudging' to the charity sector.¹³⁷ Recommendation 3, in particular, specifies 'that the ACNC should continue to prioritise its education and research functions,¹³⁸ including the use of behavioural insights and incentives' – a recommendation supported in the Government Response.¹³⁹

In contrast, ASIC's regulatory approach followed a different trajectory. Although the ACNC and ASIC's stated regulatory regimes both reflect a responsive regulatory approach,¹⁴⁰ research focusing on ASIC's regulation of directors' duties and the enforcement of the civil penalty regime in practice, point to divergent regulatory approaches. Commentators disagree on the responsive nature and success of ASIC's regulatory approach.¹⁴¹ While the ACNC's implementation of its responsive regulatory approach was reviewed positively, ASIC's implementation

133 The panel recommended that small registered entities be given the option to submit a simplified balance sheet or a statement of resources and that large registered entities be required to disclose the remuneration paid to responsible persons and senior executives on an aggregated basis: see recommendations 13 and 15 in *Strengthening for Purpose Report* (n 16) 12. The Government Response supported both recommendations: Australian Government Treasury, 'Government Response to the Australian Charities and Not-for-profits Commission Legislation Review 2018' (n 19) 13–14.

134 *ACNC Act* (n 12) s 15-10(g).

135 Australian Charities and Not-for-profits Commission, *ACNC 2016–17 Regulator Performance Framework Self-Assessment* (Report, 7 December 2017) 7.

136 *Strengthening for Purpose Report* (n 16) 33.

137 *Ibid* 31.

138 *Ibid* 33.

139 Australian Government Treasury, 'Government Response to the Australian Charities and Not-for-profits Commission Legislation Review 2018' (n 17) 8.

140 'Regulatory Approach Statement' (n 130); Australian Securities and Investments Commission, 'ASIC's Approach to Enforcement' (Information Sheet No 151, September 2013).

141 See Helen Bird, 'The Problematic Nature of Civil Penalties in the Corporations Law' (1996) 14(7) *Company and Securities Law Journal* 405, 411; George Gilligan, Helen Bird and Ian M Ramsay, 'Regulating Directors' Duties: How Effective Are the Civil Penalty Sanctions in the Australian Corporations Law?' (Research Report, University of Melbourne, Centre for Corporate Law and Securities Regulation, 1999) <https://law.unimelb.edu.au/_data/assets/pdf_file/0004/1710256/145-CivilPenaltiesFinal2.pdf>; Michelle Welsh, 'Civil Penalties and Responsive Regulation: The Gap between Theory and Practice' (2009) 33(3) *Melbourne University Law Review* 908; Ian M Ramsay and

met with heavy criticism and attracted significant public scrutiny during the past decade.¹⁴² In 2014, the Senate Economics References Committee described the regulator as ‘timid’ and ‘hesitant’.¹⁴³ More recently, the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry commented that ASIC’s ‘enforcement activities did not reflect the gravity of what its work revealed’.¹⁴⁴

3 *Responsive Regulatory Theory and the Corporations Act*

Australia’s integrated corporate, markets, financial services and consumer credit regulator, ASIC, administers the *Corporations Act*.¹⁴⁵ Considering ASIC’s broader regulatory approach, section 1(2)(g) of the *ASIC Act* directs ASIC to ‘take whatever action it can take, and is necessary ... to enforce and give effect to the laws of the Commonwealth that confer functions and powers on it’. The instruction limits the wide scope of ‘whatever action’ by specifically including the words ‘and is necessary’ in the same section.¹⁴⁶ The statutory sanctions at the disposal of ASIC in legislation, and the enforcement policy developed and published by ASIC, reflect many aspects of responsive regulation.¹⁴⁷ In 2017, the ASIC Enforcement Review Taskforce, citing the need for proportionate and tailor-made regulation as

Benjamin B Saunders, ‘An Analysis of the Enforcement of the Statutory Duty of Care by ASIC’ (2019) 36(6) *Company and Securities Law Journal* 497. See also below nn 150, 151.

142 Senate Economics References Committee, Parliament of Australia, *Performance of the Australian Securities and Investments Commission* (Final Report, 26 June 2014) (*‘Performance of ASIC’*); Australian Government Treasury, *Financial System Inquiry* (Final Report, 7 December 2014) (*‘Financial System Inquiry’*); Australian Government Treasury, *Fit for the Future: A Capability Review of the Australian Securities and Investments Commission* (Report, 4 December 2015) (*‘Fit for the Future Report’*); *ASIC Enforcement Review Taskforce Report* (n 9); *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* (Interim Report, September 2018) (*‘Royal Commission Interim Report’*); *Royal Commission into Misconduct in the Banking Superannuation and Financial Services Industry* (Final Report, 1 February 2019).

143 *Performance of ASIC* (n 142) xviii. Harris, Hargovan and Austin (n 84) describe ASIC as a ‘guardian of public interest’: at 356.

144 *Royal Commission Interim Report* (n 142) 277.

145 ASIC administers a number of statutes and parts of statutes, including the *Australian Securities and Investments Commission Act 2001* (Cth) (*‘ASIC Act’*), the *National Consumer Credit Protection Act 2009* (Cth) (*‘National Credit Act’*) and the *Banking Act 1959* (Cth) (*‘Banking Act’*). Comino argues that the administration and enforcement of the corporations legislation is ASIC’s primary role: Vicky Comino, ‘Effective Regulation by the Australian Securities and Investments Commission: The Civil Penalty Problem’ (2009) 33(3) *Melbourne University Law Review* 802, 803 (*‘Effective Regulation’*). This was a view reiterated in 2016, while highlighting that the broad scope of the regulator’s remit impacts its performance: Vicky Comino, ‘The Adequacy of ASIC’s “Tool Kit” to Meet Its Obligations under Corporations and Financial Services Legislation’ (2016) 34(5) *Company and Securities Law Journal* 360, 362 (*‘The Adequacy of ASIC’s “Tool Kit”*’). Treasury also raised the impact of ASIC’s broad remit on its performance in a submission to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry: *Royal Commission Interim Report* (n 142) 270. Consequently, the Interim Report raised the scale of ASIC’s task as an issue: at 299.

146 *ASIC Act* (n 145) s 1(2)(g).

147 *Performance of ASIC* (n 142) 29. According to Comino, in 2011, ‘strategic regulation and the pyramid model characterise[d] the current approach to corporate regulation in Australia’: Vicky Comino, ‘Towards Better Corporate Regulation in Australia’ (2011) 26(1) *Australian Journal of Corporate Law* 6, 7–8.

one of the principles guiding the review, affirmed the responsive nature of ASIC's regulatory approach, even if only aspirational.¹⁴⁸

ASIC is particularly pertinent to this discussion as it has responsibility for enforcing the statutory duties of directors contained in part 2D.1.¹⁴⁹ Since its inception in 1993, the civil penalty regime currently contained in part 9.4B of the *Corporations Act* has been the focus of many commentaries and reports.¹⁵⁰ Research examining ASIC's use of the civil penalty regime as an enforcement tool against company directors in the early years of implementation found it to be an ineffective measure.¹⁵¹ In recent years, some commentaries viewed the penalty proceedings in a more positive light.¹⁵² Many commentaries ascribed the limited success to the fact that civil and criminal penalties occupied the same level on the enforcement pyramid.¹⁵³ Others argued that the dissonance between the enforcement structure and the theory hampered the success of the civil penalty regime.¹⁵⁴

Commentaries agree that the penalty regime reflects a graduated enforcement model that corresponds with a responsive regulative approach.¹⁵⁵ However, few discussions centre around the practical application of the regulatory theory. Focusing on the regulatory nature of the civil penalty structure and its enforcement, Welsh's examination of ASIC's enforcement of sections 181 to 183 of the *Corporations Act* (provisions that may under certain circumstances be enforced by a criminal prosecution) revealed that, in practice, ASIC's regulatory approach did not reflect

148 *ASIC Enforcement Review Taskforce Report* (n 9) xx. The Review Terms of Reference specifically required the Taskforce to make recommendations that would allow more effective enforcement of the regulatory regime without imposing an undue regulatory burden on business, highlighting the underlying responsive and proportional nature of ASIC's regulatory approach: at ix. Arguably, the reference signals the need for improvement in the area. In contrast, the Terms of Reference of the ASIC Capability Review specifically excluded recommendations on ASIC's regulatory framework or powers: *Fit for the Future Report* (n 142) 1.

149 *Performance of ASIC* (n 142) 17.

150 For example, see Bird (n 141); George Gilligan, Helen Bird and Ian Ramsay, 'The Efficacy of Civil Penalty Sanctions under the Australian Corporations Law' (1999) 136 *Trends and Issues in Crime and Criminal Justice* 1; Helen Bird and George Gilligan, 'Deterring Corporate Wrongdoing: Penalties, Financial Services Misconduct and the *Corporations Act 2001* (Cth)' (2016) 34(5) *Company and Securities Law Journal* 359; Comino, 'Effective Regulation' (n 145); Comino, 'The Adequacy of ASIC's "Tool Kit"' (n 145); Michael Gething, 'Do We Really Need Criminal and Civil Penalties for Contraventions of Directors' Duties?' (1996) 24(5) *Australian Business Law Review* 390; Joshua P Knackstredt, 'The Evolution in Civil Penalty Proceedings' (2006) 24(1) *Company and Securities Law Journal* 56; Ramsay and Saunders (n 141); Tomasic (n 117); Welsh, 'Civil Penalties and Responsive Regulation' (n 141); *Performance of ASIC* (n 142); *ASIC Enforcement Review Taskforce Report* (n 9).

151 Bird (n 141); George P Gilligan, Helen Bird and Ian Ramsay, 'Civil Penalties and the Enforcement of Directors' Duties' (1999) 22(2) *University of New South Wales Law Journal* 417, 452.

152 Ramsay and Saunders argue that, bearing in mind that civil penalty proceedings are time-consuming and costly, ASIC has fared well to bring 46 proceedings in 25 years: Ramsay and Saunders (n 141) 517.

153 Gilligan, Bird and Ramsay (n 151) 431; Welsh (n 141) 913–14.

154 Comino, 'Effective Regulation' (n 145) 805–7; Jasper Hedges and Ian Ramsay, 'Has the Introduction of Civil Penalties Increased the Speed and Success Rate of Directors' Duties Case?' (2016) 34(7) *Company and Securities Law Journal* 549, 551, citing Australian Securities and Investments Commission, Submission No 49 to Senate Economics References Committee, *Criminal, Civil and Administrative Penalties for White Collar Crime* (April 2016) [58]–[65].

155 Comino, 'Towards Better Corporate Regulation in Australia' (n 147) 8; Gilligan, Bird and Ramsay (n 151) 419; Ramsay and Saunders (n 141) 502.

a responsive regulatory approach. She argued that ASIC's approach in practice deviated from strategic regulative theory in abstract because ASIC acts in a public and political environment in which it is required to justify any decision not to prosecute criminally and that responsive regulation theory does not adequately address the influence that such external pressures have on the strategies adopted by a regulator.¹⁵⁶ Arguably, the limited use of civil penalties and the apparent divergence between practice and theory reflect the reality of a public regulator required to justify the spending of public money. When faced with alternative penalties, it will most likely choose the penalty that delivers greater impact with proportionally less resources.¹⁵⁷

The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services criticised ASIC for its light-touch approach to non-compliance in the finance sector.¹⁵⁸ However, the regulator's responses to breaches of directors' duties do not reveal a similar reticence to take enforcement action. The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry reflected that, prior to April 2018, ASIC had never instigated a civil penalty proceeding against an individual financial adviser for a breach of the best interests duty.¹⁵⁹ Comparably, the regulator commenced 46 civil penalty proceedings, for a breach of directors' duty of care and skill between 1998 and 2017.¹⁶⁰ Moreover, case law reflects a tendency to aim for the higher end of the penalty scale which is then tempered by the court's judgment.¹⁶¹ The establishment of an Office of Enforcement, indicative of an increased emphasis on court-based enforcement action combined

156 Welsh (n 141).

157 Welsh makes the point that while opting for criminal prosecution without following a strategic regulatory approach when both civil and criminal penalties are available, it appears that ASIC is influenced by responsive regulation when a criminal prosecution is not available: *ibid* 927, 933. Considering the Wallis Inquiry's recommendation that '[i]n all cases, the cost effectiveness of regulation should be subject to ongoing stringent assessment', financial considerations and cost-effective regulation would definitely loom large for ASIC: *Financial System Inquiry* (n 142) 15. Budgetary considerations remain a significant issue: Many ASIC witnesses raised cost-effectiveness and limited resources during the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry: *Royal Commission Interim Report* (n 142) 285–9.

158 *Royal Commission Interim Report* (n 142) 287.

159 *Ibid* 275.

160 Ramsay and Saunders (n 141) 504.

161 The court reduced the penalties ASIC asked for in *Gillfillan v Australian Securities and Investments Commission* (2012) 92 ACSR 460 and *Morley v Australian Securities and Investments Commission* [No 2] (2011) 83 ACSR 620. In *Australian Securities and Investments Commission v Healey* [No 2] [2011] FCA 1003 ('*Healey* [No 2]'), Middleton J not only reduced the penalty, but he also did not impose any pecuniary penalty. The judgment dealt with the question of penalties and applications for relief from liability after the court's finding of liability in *Australian Securities and Investments Commission v Healey* [2011] FCA 717 ('*Healey*'). Although Middleton J determined that the non-executive directors should not be exonerated and declarations of contravention should be made, he declined to impose the disqualification orders ASIC sought: *Healey* [No 2] 433 [4].

with a significant increase in penalties from March 2019,¹⁶² signals that ASIC's response to breaches of directors' duties is unlikely to change.¹⁶³

What are the consequences of breaching a statutory directors' duty? The next section considers this question in light of ASIC's history of enforcement of the statutory directors' duties contained in the *Corporations Act*.

C For Individual Directors: Exposure to Exorbitant Civil Penalty Provisions

Importantly, turning sections 180 to 183 back on for charity directors would mean that persons volunteering time and expertise as charity directors for the greater public benefit would expose their reputations and finances to extraordinary risk – the financial consequences for a breach of the statutory duties of good faith and care and skill increased significantly when the *Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Act 2019* (Cth) amended the *Corporations Act* in March 2019.¹⁶⁴ From 1 July 2020, directors breaching the statutory duties contained in sections 180(1), 181(1)–(2), 182(1)–(2) and 183(1)–(2) are exposed to a pecuniary penalty of up to \$1.11 million, or three times the benefit gained or loss avoided by the contravening conduct.¹⁶⁵

Arguably, the reduced fines imposed in a number of cases related to directors' duties provide grounds for hope that the courts will not lightly impose the maximum penalties on negligent not-for-profit directors.¹⁶⁶ However, the mere possibility of a million-dollar fine is sufficient to deter risk-averse volunteers. Furthermore, a brief survey of Australian judgments on the duty of care and skill indicates that charity directors would have good reason to be concerned about a high pecuniary fine under the *Corporations Act*.

162 The *Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Act 2019* (Cth) implements recommendations of the ASIC Enforcement Review Taskforce. It amended the *Corporations Act* (n 15), the *ASIC Act* (n 12), the *National Consumer Credit Protection Act 2009* (Cth) and the *Insurance Contracts Act 1994* (Cth). It significantly strengthens existing penalties and introduces new penalties for non-compliance. Part V(C) of this article unpacks the new civil penalty structure in greater detail.

163 In February 2019, ASIC Deputy Chair Daniel Crennan QC commented that 'ASIC will now be in a stronger position to pursue harsh civil penalties and criminal sanctions against those who have breached the corporate laws of Australia': Australian Securities and Investments Commission, 'ASIC to Pursue Harsher Penalties after Laws Passed by Senate' (Media Release 19-032MR, 15 February 2019).

164 The *Treasury Laws Amendment Act* received royal assent on 12 March 2019 and commenced on 13 March 2019. The *Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Regulations 2019* (Cth) commenced on 26 March 2019. The new laws were introduced in response to the recommendations of the ASIC Enforcement Review Taskforce, established in 2016 to review the enforcement tools available to ASIC. A key aspect of these amendments is the enhancement of the civil and criminal penalty provisions of several statutes administered by ASIC: Liam Cavell, 'Tougher Laws and More Resources Signal a New Era in ASIC Enforcement' (2019) (55) *Law Society of New South Wales Journal* 84.

165 The pecuniary penalty applicable to the contravention of a civil penalty provision by an individual is the greater of 5,000 penalty units or if the Court can determine the amount, three times the benefit derived from (or detriment avoided by) the contravention: *Corporations Act* (n 15) s 1317G(3). Importantly, the risk will grow – the penalty unit values in the *Corporations Act* are indexed automatically under section 4AA of the *Crimes Act 1914* (Cth), causing the value of the fine to increase every three years. The next index-based adjustment is scheduled for 1 July 2023: at s 4AA(3).

166 See above n 161.

The next sections provide a brief overview of Australian court decisions relating to volunteer and non-executive directors' duties of care and skill and identify several issues of concern for volunteer charity directors.

1 Volunteer and Non-executive Directors in the Courts

Prior to the early 1990s and the judgments in *Commonwealth Bank of Australia v Friedrich* ('*Friedrich*'),¹⁶⁷ and *Commonwealth Bank v Eise* ('*Eise*'),¹⁶⁸ the courts' approach in applying the duty of care and skill to volunteer directors in discharging their duties was unclear. Both judgments concern the legal position of Maxwell Eise, an honorary and part-time director of a not-for-profit company, the National Safety Council of Australia ('NSC') in relation to a claim under section 556 of the *Companies (Victoria) Code*.¹⁶⁹ The NSC borrowed money from the State Bank of Victoria (the legal predecessor of Commonwealth Bank) at a time when the NSC's liabilities outweighed its assets. However, as a result of the fraudulent activities of its CEO, Mr John Friedrich, the NSC's accounts showed an excess of assets over liabilities. All the directors signed the directors' report and the directors' statement on the relevant accounts despite not having seen or read the auditor's report. The bank lodged a claim against each member of the NSC board under section 556(1) of the *Companies (Victoria) Code*. The claim was for moneys lent to NSC in the amount of \$97 million. All of the directors except Eise settled. Mr Eise was held liable for a \$96,704,998 corporate debt following the insolvency of the company.¹⁷⁰

The two judgments clearly signalled that when considering breaches of directors' duties, volunteer status does not translate into a diminished duty of care and skill or reduced consequences.¹⁷¹ Referring to the *Companies (Victoria) Code*, in particular, Tadgell J noted that none of the provisions in the *Code* supported the notion that the standards of conduct expected of part-time non-executive directors of not-for-profit companies are any different from that of directors of profit-making companies.¹⁷² Justice Fullagar confirmed this view in *Eise*.¹⁷³ He reiterated that Eise failed to convince the court that the legislature did not intend for the stringent statutory provisions to apply to not-for-profit companies.¹⁷⁴

The Safety Council was a not-for-profit company, and all the directors were volunteers. Consequently, notwithstanding Tadgell J specifically pointing out that the decision did not require the court to examine the duties of directors of

167 (1991) 9 ACLC 946 ('*Friedrich*').

168 *Eise* (n 3).

169 *Companies (Application of Laws) Act 1981* (Vic) sch 4 s 556 ('*Companies (Victoria) Code*'). The *Code* was repealed by the *Corporations Act 1989* (Cth), which in turn was repealed by the *Corporations Act* (n 15). Section 556 is currently contained in the *Corporations Act* (n 15) s 588G.

170 *Friedrich* (n 167) 1013.

171 *Ibid* 948, 1012.

172 *Ibid* 1011. One could speculate that Tadgell J's comment in obiter that the company was, for all intents and purposes, a commercial one and that the use of the company limited by guarantee form was inappropriate, indicates that the seemingly harsh decision to treat Mr Eise on the same footing as a commercial director was peculiar to the specific facts of the case. However, the issue has not been raised in court since.

173 *Eise* (n 3).

174 *Ibid* [4].

a not-for-profit company per se, the decision had wide-ranging implications for directors of not-for-profit organisations.¹⁷⁵ The judgment confirmed that Australian courts applied one standard of care for non-executive directors, irrespective of the commercial or charitable nature of the company. The extension of regulatory principles designed for commercial, profit-oriented companies to charities is, however, problematic.¹⁷⁶ The concepts and language of officers' and directors' duties in a corporate environment do not translate seamlessly to the charity sector. Different values and perspectives inform the decision-making of directors of commercial companies and charitable companies. In a traditional profit-seeking environment, investor confidence and driving shareholder value are paramount. In contrast, organisation around mission and serving public benefit are key aspects of a charity.¹⁷⁷ Furthermore, the impact following a breach of directors' duties in a corporate environment are distinctly different from the fallout of a breach in the charity sector serving mostly vulnerable members of society.¹⁷⁸

Recently, volunteer directors' conduct and liability for breaches of the statutory duty of care and diligence in section 180 were considered again in *Australian Securities and Investments Commission v Mitchell [No 2]* and *Australian Securities and Investments Commission v Mitchell [No 3]* (collectively, 'Mitchell decisions').¹⁷⁹ Although the Court recognised the good faith of Harold Mitchell, a non-executive director, and found that Tennis Australia did not suffer any harm, he was fined \$90,000 for a breach of his statutory duty of care and diligence.¹⁸⁰ Notably, ASIC sought a penalty of \$150,000.¹⁸¹ The facts of the matter eventuated

175 Sievers (n 2) 338; R Baxt, 'Whether Courts Can Relieve Directors of Liability under s 592 of the *Corporations Law*: Possibility of Separate Laws for Part-Time or Honorary Directors' (1991) 65(12) *Australian Law Journal* 737, 738.

176 Myles McGregor-Lowndes, 'Nonprofit Corporations: Reflections on Australia's Largest Nonprofit Insolvency' (1995) 5(4) *Australian Journal of Corporate Law* 417, 438, convincingly argues that unsuitable regulation played a role in the regulatory failure associated with the National Safety Council of Australia.

177 Jeffrey A Alexander and Bryan J Weiner, 'The Adoption of the Corporate Governance Model by Nonprofit Organisations' (1998) 8(3) *Nonprofit Management and Leadership* 223, 225, 239 <<https://doi.org/10.1002/nml.8302>>; Rosemary Teele Langford, 'Purpose-Based Governance: A New Paradigm' (2020) 43(3) *University of New South Wales Law Journal* 954, 960 <<https://doi.org/10.53637/TDWS1787>>. See also Richard Bush, 'Survival of the Nonprofit Spirit in a For-Profit World' (1992) 21(4) *Nonprofit and Voluntary Sector Quarterly* 391, 394–5 <<https://doi.org/10.1177/089976409202100406>>.

178 McGregor-Lowndes, 'Nonprofit Corporations: Reflections on Australia's Largest Nonprofit Insolvency' (n 176) 417, 430.

179 *Australian Securities and Investments Commission v Mitchell [No 2]* (2020) 382 ALR 425 ('*Mitchell [No 2]*'); *Australian Securities and Investments Commissions v Mitchell [No 3]* (2020) 148 ACSR 630 ('*Mitchell [No 3]*'). ASIC alleged that in the internal deliberation by Tennis Australia in respect of securing domestic broadcast rights, and in its negotiations with the Seven Network for such rights, Stephen Healy and Harold Mitchell breached section 180(1) of the *Corporations Act* (n 15) by failing to exercise the degree of care and diligence that a reasonable person in their position would exercise. ASIC further alleged that Mr Mitchell breached sections 182(1) and 183(1) by improperly using his position as a director of Tennis Australia and information gained from that the position to gain an advantage for the Seven Network during the course of its negotiations with Tennis Australia.

180 *Mitchell [No 3]* (n 179) [16]–[17], [1713]–[1714].

181 *Ibid* [4] (Beach J). A \$150,000 penalty equals 75% of the then maximum penalty of \$200,000 which has since been adjusted to \$1.11 million.

before the *ACNC (Consequential and Transitional) Act 2012* (Cth) came into effect. The judgment, therefore, does not clarify the uncertain position of charity directors since July 2013. It does, however, illustrate the penalty risk charity directors would be exposed to if Recommendation 11 is adopted.

Justice Beach acknowledged the not-for-profit nature of Tennis Australia and seemed to be influenced by it when he considered the legal position of the chairperson, Stephen Healy.¹⁸² ASIC's case against Healy failed. The not-for-profit nature of Tennis Australia was, however, not mentioned with reference to Harold Mitchell's position.¹⁸³ Justice Beach's obiter comments about the application of sections 1317S and 1318 affirmed Tadgell and Middleton JJ's approach to treat directors of not-for-profit and commercial companies the same.¹⁸⁴

It is appropriate, therefore, to consider the court's views on the duty of care and skill of non-executive directors in commercial companies.¹⁸⁵

Daniels v Anderson ('*Daniels*')¹⁸⁶ constitutes a watershed moment in the history of the regulation of directors' duty of care and skill.¹⁸⁷ In this case, the Supreme Court of New South Wales had to consider an appeal from a decision that auditors and the managing director of a company were liable for the consequences of a failure to set up an adequate system of internal control and recording of foreign

182 *Mitchell [No 2]* (n 179) [1147]–[1148].

183 *Ibid* [1142]–[1148]. See also Anil Hargovan, 'Governance Lessons from Tennis Australia: *ASIC v Mitchell [No 2]*' (2020) 72(8) *Governance Directions* 384; McGregor-Lowndes and Hannah (n 80).

184 *Mitchell [No 2]* (n 179) [1512]. Beach J acknowledged the not-for-profit status of Tennis Australia, its charitable purpose, the volunteer status of its directors, specifically the first defendant, Steve Healy, and his honesty and good faith. Nevertheless, in response to Healy's assertion that he should be relieved from liability given the circumstances of the case, including those connected with his appointment, his Honour indicated that if the question should arise, he could not 'sensibly speculate' about circumstances that would fairly excuse Mr Healy for the contravention. Contrast the decision in *Official Receiver v Batmanghelidjh* [2021] EWHC 175 (Ch), a prominent United Kingdom ('UK') case involving the Kids Company charity, where Falk J reiterated the English courts' 'benevolent approach towards charity trustees': at [847]–[855]. Falk J noted that the consequences following the same incompetent conduct could be different for directors of commercial companies as opposed to volunteer directors/trustees of charitable companies: at [852]. It concluded that the charitable status of the company, and the volunteer status of trustees/directors are relevant to the context: at [863]. Notwithstanding the differences between UK and Australian disqualification provisions and the somewhat different context, the decision points to a significantly different approach. The position taken by ASIC in *Mitchell [No 2]* (n 179) and the Court's analysis across a range of issues raise important questions. These will benefit from close consideration by the charity community.

185 Treating non-executive directors of charitable companies and commercial companies the same raises the question as to whether the parity extends to the assessment of executive directors. Austin J, including a reference to non-executive directors when he explained what a minimum standard of diligence requires of 'every director or officer, including a non-executive director', points to such an approach: *Rich* (n 87) 132 [7203]. However, for purposes of this discussion, a focus on non-executive directors suffices. Thea Voogt, 'Articulating Care, Skill and Diligence Standards for Non-executive Directors' (2017) 35(2) *Company and Securities Law Journal* 128, provides an instructive comparison of the position of non-executive directors in law and the position as reflected by the ASX Corporate Governance Council: ASX Corporate Governance Council, 'Corporate Governance Principles and Recommendations: 4th Edition' (February 2019).

186 *Daniels v Anderson* (1995) 37 NSWLR 438 ('*Daniels*').

187 Jean Jacques Du Plessis described the judgment as representing 'the pinnacle in Australia ... of the development of directors' duty of care, skill and diligence': Du Plessis (n 82) 271.

exchange dealings.¹⁸⁸ The judgment is particularly relevant to this discussion for two of its findings: that the question whether a director breached their duty should be determined objectively,¹⁸⁹ and that the objective test is equally applicable to both executive and non-executive directors.¹⁹⁰ Combined with the finding that ordinary negligence, rather than gross negligence or recklessness is sufficient to hold directors liable for a breach of their duty of care,¹⁹¹ and the court's rejection of the traditional approach to subjective elements,¹⁹² the judgment raised the benchmark for volunteer charity directors significantly.

In 2009, Middleton J raised the standard set in *Daniels* even further in the landmark case of *Australian Securities and Investments Commission v Healey* ('*Healey*'),¹⁹³ a decision that largely focused on non-executive directors and the level of financial literacy they are required to have. The case concerned the board's approval of financial statements and a directors' report which failed to disclose crucial matters, including significant amounts of short-term debt, and guarantees for short-term debt. Furthermore, the short-term debt burden was misclassified, giving a false view of the company's short-term debt burden. Justice Middleton was at pains to convey the importance of directors as an essential component of corporate governance, describing directors as 'placed at the apex of the structure of direction and management of a company'.¹⁹⁴ With reference to the duty to be involved in the management of the company and to take all reasonable steps to be able to guide and monitor a company, he stressed that 'all directors must carefully read, understand and focus upon the contents of financial reports'.¹⁹⁵ Discussing the importance of reading the financial statements, Middleton J referred to the minimal steps 'a person in the position of any director would and should take'.¹⁹⁶ The judgment reiterated the principles laid down by Tadgell J in *Friedrich*,¹⁹⁷ serving as a stark reminder to charity directors to pay proper attention in the execution of board functions.¹⁹⁸

Both the *Friedrich* and the *Australian Securities and Investments Commission v Healey [No 2]* ('*Healey [No 2]*') judgments¹⁹⁹ considered the defendants' application for relief from liability under section 535 of the *Companies (Victoria) Code* and

188 *Daniels* (n 186) 445 (Clarke and Sheller JJA).

189 'This means conduct ordinarily measured by reference to what the reasonable man of ordinary prudence would do in the circumstances': *ibid* [665]. Du Plessis highlights the significance of the court finding that the general law relating to the tort of negligence was an appropriate basis for the claim of common-law damages against negligent directors: Du Plessis (n 82) 272–5.

190 *Daniels* (n 186) 500–1.

191 *Ibid* 504–5.

192 *Ibid* 503–4.

193 *Healey* (n 161).

194 *Ibid* [14].

195 *Ibid* [17] (emphasis added).

196 *Ibid* [22] (emphasis added).

197 *Friedrich* (n 167).

198 Colin Sharp highlighted the importance and implications of the finding for the not-for-profit sector in a commentary published a few months before the *ACNC Act* (n 12) came into effect: Sharp (n 3).

199 *Friedrich* (n 167); *Healey [No 2]* (n 161).

its successor(s), sections 1317S and 1318 of the *Corporations Act* respectively.²⁰⁰ The sections, along with the business judgment rule in section 180(2), provide honest and assiduous directors potential statutory protection against personal liability for breaches of the duty of care and diligence.²⁰¹ It is useful, therefore, to discuss the practical application and success of the provisions as measures that could ameliorate the imposition of the high penalties in the *Corporations Act*'s civil penalty regime.

2 Statutory Relief from Liability for and Exoneration from Duty of Care Breaches

Sections 1317S and 1318 give the court the power to relieve directors from liability arising out of a breach of their statutory and general law care and skill duties if it is satisfied that the director acted honestly and that, 'having regard to all the circumstances of the case, the person ought fairly to be excused'.²⁰² Although a successful application for relief does not remove the breach, it excuses the applicant and removes some or all of the liability.²⁰³ As illustrated by the judgments in *Friedrich*, *Healey [No 2]* and the *Mitchell* decisions, the relief is rarely granted.²⁰⁴

Justice Tadjell acknowledged that the relief provisions serve the public interest by balancing the need to make directors accountable for their conduct, whilst not deterring able people from offering their services for want of appropriate protection.²⁰⁵ However, he rejected Mr Eise's claim for relief. He found that liability under section 556(1) does not depend on a breach of any duty owed by a defendant to a plaintiff. Consequently, that the relief provisions contained in the *Companies (Victoria) Code* did not apply to a breach of section 556 and therefore, not to Mr Eise's case.²⁰⁶ However, he concluded that even if the provisions had applied, they would not excuse Mr Eise, a voluntary non-executive director of a not-for-profit organisation, from liability.²⁰⁷ Importantly, the court made the finding despite recognising that Mr Eise was 'honest and public-spirited'²⁰⁸ and recognising the

200 *Friedrich* (n 167) [952] (Tadjell J); *Healey [No 2]* (n 161) 296 [4] (Middleton J). Justice Beach addressed the applicability of the sections in his obiter comments: *Mitchell [No 2]* (n 179) 687 [1512].

201 Australian Government Treasury, 'Directors' Duties and Corporate Governance: Facilitating Innovation and Protecting Investors' (Corporate Law Economic Reform Program Proposals for Reform Paper No 3, 1997) 25, 40 ('Directors' Duties and Corporate Governance').

202 See LexisNexis, *Ford, Austin & Ramsay's Principles of Corporations Law* (online at July 2020) [9.700] ('Exoneration by Court'). Sections 1317S and 1318 are substantially identical: *Healey [No 2]* (n 161) [83].

203 *Healey [No 2]* (n 161) [86].

204 This overview focuses on the court's approach to determine whether the duty of care and skill was breached. It does not, therefore, analyse jurisprudence on the question of relief in detail beyond Tadjell J, Middleton J and Beach J's comments. It is notable, however, that the court denied applications for relief, if raised, in all the cases discussed in this overview. The court's reluctance to grant relief under sections 1317S and 1318 renders it ineffective as protection against the consequences of a breach of duty. See also Michael Legg and Dean Jordan, 'The Australian Business Judgment Rule after "*ASIC v Rich*": Balancing Director Authority and Accountability' (2013) 34(2) *Adelaide Law Review* 403, 408.

205 *Friedrich* (n 167) 1021.

206 *Ibid* [1008].

207 *Ibid* [1011]–[1012].

208 *Ibid* [963].

magnitude of the fraud he fell victim to.²⁰⁹ In *Healey [No 2]*, Middleton J declined to relieve the defendants from liability, but he did not impose any penalty beyond the declarations of contravention on the non-executive directors.²¹⁰

In contrast to the relief from liability provisions, the business judgment rule is a defence which, if successfully raised, excuses the conduct and negates a breach of the statutory as well as general law duty of care and skill.²¹¹ The rule was introduced in section 180(2) of the *Corporations Act 1989* (Cth)²¹² after the decision in *Daniels* caused considerable concern about directors' potential personal liability for business decisions.

To address these concerns and encourage entrepreneurial enterprise, the *Corporations Act* was amended to include a statutory business judgment rule, 'offering directors a safe harbour from personal liability for breaches of the duty of care and diligence in relation to honest, informed and rational business judgements'.²¹³ Arguably, the defence created in section 180(2) did not achieve its intended purpose – it was raised successfully only once during the first fifteen years since its introduction.²¹⁴ Consequently, the business judgment rule is widely criticised for failing to provide the safe harbour touted in arguments supporting the adoption of the rule.²¹⁵ It, therefore, provides cold comfort to charity directors.

The high standards of directors' duties discussed in Part V(C)(1), combined with the failure of the business judgment rule to provide adequate protection and the courts' reticence to grant relief mean that volunteer directors face real risks in relation to personal liability and fines relating to breaches of directors' duties.²¹⁶

The complexity of the duties of directors of charities should not be underestimated. Adopting Recommendation 11 will add another layer to compliance. Although the

209 Ibid [950].

210 *Healey [No 2]* (n 161) [3], [102].

211 According to Austin J, it goes to the heart of the question whether a director breached a duty of care and skill: *Rich* (n 87) [7253].

212 *Corporate Law Economic Reform Program Act 1999* (Cth) sch 1.

213 'Directors' Duties and Corporate Governance' (n 201) 21. See also Harris and Hargovan, 'Still a Sleepy Hollow? Directors' Liability and the Business Judgment Rule' (2017) 31(3) *Australian Journal of Corporate Law* 319, 322–3; Ricci and Miyairi (n 91) 1; Jean J Du Plessis and Jim A Mathiopoulos, 'Defences and Relief from Liability for Company Directors: Widening Protection to Stimulate Innovation' (2017) 31(3) *Australian Journal of Corporate Law* 287, 292.

214 In *Australian Securities and Investments Commission v Mariner Corporation Limited* (2015) 241 FCR 502, 591 [495], Beach J found that 'Mr Olney-Fraser has satisfied the requisite elements of the business judgment rule and is entitled to its exculpatory operation if he otherwise needs to rely on it'. He followed a similar approach in relation to the other two directors. In *Deangrove Pty Ltd (Recs Apptd) (Mgrs Apptd) v Buckley* (2006) 56 ACSR 630, Branson J held that section 180(2) applied, but in principle only as he found that the defendant did not breach section 180(1). However, Harris and Hargovan argue that the rare successes may not be the result of a flaw in the rule itself: Harris and Hargovan (n 213) 341.

215 See, eg, Robert Baxt, 'The Corporate Law Scene in 2012: Trouble for Directors, Greater Power to the Regulator, Even More Legislation and Regulation, and Much More Litigation' (2012) 40(1) *Australian Business Law Review* 49 ('The Corporate Law Scene'); Young (n 8) 222; Ricci and Miyairi (n 91) 38; Legg and Jordan (n 204) 426; Justice Berna Collier, 'Recent Developments in Australian Corporate Governance' (Speech, New Zealand Law Society's Corporate Governance Intensive, 1–2 June 2017); Du Plessis and Mathiopoulos (n 213) 297–8.

216 According to Baxt, 'a tough, and some would argue relatively inflexible, stance': Baxt, 'The Corporate Law Scene' (n 215) 49.

duties under the *Corporations Act* and those under the governance standards largely overlap, there are some subtle differences.²¹⁷ Consequently, directors would need to take steps to make sure that they are meeting both sets of requirements, resulting in a duplication of regulation and additional penalties for directors. Undoubtedly, legal duties and obligations and the increased liability exposure will be top of mind for existing as well as potential board members.²¹⁸ It is difficult to see how the increase in obligations and complexity will make volunteer board positions more attractive.²¹⁹

VI CONCLUSION

This article explored the possible impact of turning the statutory duties and associated civil penalties contained in the *Corporations Act* back on for ACNC-registered companies. It focused on the development of responsive regulation in the charity sphere, on charities' compliance burden and on the personal liability of individual directors of charitable companies.

It drew attention to the far-reaching and negative effect adopting and implementing Recommendation 11 could have on the charity sector: adopting the recommendation would dilute the positive impact of the ACNC's collaborative capacity-building regulatory approach and impede its further development. Furthermore, it would increase charities' regulatory burden by effectively subjecting companies registered with the ACNC to two regulators with contrasting and incompatible regulatory approaches. Finally, the discussion illustrated how turning sections 180 to 183 of the *Corporations Act* back on would significantly increase charity directors' personal liability exposure, likely to result in an even smaller number of volunteer directors.

Admittedly, the uncertainty surrounding the legal position of charity directors must be addressed to avoid harming the sector and to ensure charities are able to maintain their vital contribution to the socio-economic welfare of Australia.

217 Ramsay and Webster (n 38).

218 More so, in view of ASIC's declared focus on 'deterrence, public denunciation and punishment of wrongdoing by way of litigation': Australian Securities and Investments Commission, 'Update on Implementation of Royal Commission Recommendations', (Media Release 19-035MR, 19 February 2019) 13.

219 The *Australian Charities and Not-for-profits Commission Amendment (2021 Measures No 2) Regulations 2021* (Cth) proposed regulations that were disallowed by the Senate in November 2021, should also be noted. The proposed regulations would have required registered charities to 'maintain reasonable internal control procedures' to ensure that their resources are not used to commit certain types of summary offences, thereby imposing additional compliance burdens on charities and their responsible entities. Although unsuccessful, the government's proposal raises red flags regarding future increases in charity compliance requirements and charity directors' legal duties and obligations. See Wendy Williams, "'There's No Need for These Regulations': Charities Fear Changes to Governance Standards Will Have a Negative Effect', *Pro Bono Australia* (Web Page, 27 July 2021) <<https://probonoaustralia.com.au/news/2021/07/theres-no-need-for-these-regulations-charities-fear-changes-to-governance-standards-will-have-a-negative-effect/>>; Krystian Seibert, 'The Government is Clamping Down on Charities: And It Could Have a Chilling Effect on Protest', *The Conversation* (online, 2 July 2021) <<https://theconversation.com/the-government-is-clamping-down-on-charities-and-it-could-have-a-chilling-effect-on-peaceful-protest-163493>>. See also comments in Part II(C) of this article.

However, corporate regulatory values should be imposed with caution on charitable companies and with due regard for their unique characteristics. Imposing unrealistic compliance and complexity that is beyond charity capabilities, while also depleting the leadership pool and stifling regulatory development, could do significant long-term damage to the sector. Given the importance of the charity sector in Australian communities, Australian society will also suffer.²²⁰ Changes to the regulatory structure should, therefore, be approached with circumspection.

220 'We could tear the fabric of a sector that does so much good work and is a key part of the economy': George Savvides FAICD, a former managing director of Medibank Private and World Vision Australia chair, quoted in Tony Featherstone, 'Putting the Squeeze on Charity' (2018) 34(3) *Company Director* 45, 46.