

LAWS2203/6203 Corporations Law

Lecture notes

Piercing the veil of incorporation

- Statutory provisions that have the effect of piercing or looking behind the corporate veil:
 - o Director's liability for insolvent trading
 - Directors may become personally liable for debts incurred by their company. This arises where directors breach the duty contained in s588G by failing to prevent the company incurring debts when there are reasonable grounds for suspecting that it is insolvent.
 - o Uncommercial transactions (s 588 FB)
 - o Security interests granted to officers (s 588FP)
 - o Financial assistance
 - o Taxation legislation
 - Directors may be liable to pay the company's remitted PAYG tax instalments and other similar liabilities.

- *Salomon v Salomon & Co Pty Ltd* [1897] AC 22
 - o The House of Lords maintained that the fact that Salomon & Co Ltd was a 'one man' company made no difference. Upon incorporation a separate legal entity is created even if all the company's issued shares are beneficially owned by the same person.

- *Lee v Lee's Air Farming Ltd* [1961] AC 12
 - o Worker's compensation can be paid to the plaintiff when he was owning the company?
 - o *Salomon's* case applied, the company is the one who took out the insurance and the director, although is the owner of the company, is an employee himself.

- *Prest v Petrodel Resources Ltd* [2013] UKSC 34
 - o The court may disregard the corporate veil if there is a legal right against the person in control of it which exists independently of the company's involvement, and a company is interposed so that the separate legal personality of the company will defeat the right or frustrate its enforcement.

- Fraud
 - o *Re Darby* [1911] 1 KB 95
 - It was argued that the profit was made by the company formed by Darby and Gyde and not by Darby himself. This argument was rejected and Darby was ordered to disgorge his profit because the company he set up was a "dummy company" formed for the purpose of enabling him to perpetrate a fraud. Thus the court looked behind the façade of the legal entity.
 - o Avoidance of legal obligations
 - The courts will pierce the corporate veil if a company has been used as a sham so as to avoid a legal obligation under the contract or statute.
 - *Gilford Motor Co Ltd v Horne* [1933] Ch 935
 - Gilford Motor brought an action seeking to restrain Horne and the company he formed from soliciting their customers, whom Horne was in liaison with when he was working for Gilford Motor. Lord Handworth MR considered that the company was a "mere cloak or sham" used as a device for enabling contractual obligations to be avoided.
 - o Involvement in directors' breach of duty
 - *Green v Bestobell Industries Pty Ltd* [1982] WAR 1
 - Green's own incorporated company submitted a tender for a contract when he was a director of the defendant and subsequently won the contract.

- WASC held that Green breached his fiduciary duty to Bestobell by placing himself in a position where his duty to it conflicted with his own interests.
- Attributing mind and will of company
 - Where it is necessary to determine the purpose or intention of a company the corporate veil will be pierced.
 - However this attribution is only made in respect of the persons who are regarded as the “directing mind and will” if a company rather than mere employees.

Lifting the corporate veil of group companies

- *Adams v Cape Industries plc* [1990] 1 Ch 433
 - Slade LJ: “the court is not free to disregard the principle of *Salomon v A Salomon & Co Ltd* merely because it considers that justice so requires. Our law, for better or worse, recognises the creation of subsidiary companies, which though in one sense the creatures of their parent companies, will nevertheless under the general law fall to be treated as separate legal entities with all the rights and liabilities that would normally attach to separate legal entities”
 - *Corporations Act* will nominate situations where the courts look behind the corporate veil and treat a group of companies as a single economic entity.
- Holding company’s liability for insolvent trading by subsidiary
 - S588V – 588X makes holding companies liable for the debts incurred by their insolvent subsidiaries.
 - A holding company may be personally liable to the liquidator of its subsidiary if it fails to prevent the subsidiary incurring debts while insolvent.
 - A company also incurs a debt when a company exposes itself to an obligation to pay taxes: *Powell v Fryer* [2001] SASC 59
- Consolidated financial statements
 - For the purpose of providing more meaningful information to investors and the market.
 - S296 requires a company’s financial report to comply with accounting standards.
- Taxation consolidation
 - Corporate groups headed or controlled by an Australian company may elect to lodge a single consolidated tax return for the entire group.
 - This enables intra-group transactions to be ignored and permits pooling of losses and franking credits.
- The benefit of the group as a whole
 - *Equiticorp Finance Ltd (in liq) v Bank of New Zealand* (1993) 32 NSWLR 50
 - The NSWCA agreed with the *Walker v Wimborne* principle that directors of associated companies owe separate duties to act in the best interests of each company.
 - However it recognised that in some circumstances a transaction that is entered into for the benefit of one or more companies in the group can have derivative benefits for other companies in the group.
 - Transaction benefited the group as a whole, it also indirectly benefited the transferring companies.
- Pooling in liquidation
 - *Qintex Australia Finance Ltd v Schroders Australia Ltd* (1991) 9 ACLC 109

Trust Co v Rudderham 1 NSR (2d) 379

- Purchase share price is not a determinant.
- *Gambatto*: Mchugh J: requires the majority shareholders, through the company, to make full disclosure of all matters that may affect a judgment as to the fairness of the proposed alteration of the constitution.
 - Current and historical market prices
 - Net book value of the assets
 - Value of the company
- Onus of proof – it is for the majority to prove the validity of the alteration.
- Equitable limits on the power to alter the constitution:
 - Amendments authorising expropriation of shares;
 - Amendments authorising expropriation of valuable proprietary rights attaching to shares;
 - Other amendments to articles giving rise to a conflict of interests.
- Expropriation
 - Expropriation can also include the cancellation of shares rather than the forced transfer of those shares, and can also include the extinguishment of valuable rights attached to shares: *Young v The Owners Strata Plan No 3529* (2001) 54 NSWLR 60

Assent to transaction

- Corporates entering into contract
 - Section 124
 - Company has the legal capacity and powers of individual.
 - Section 126(1)
 - Individual directors cannot represent a corporate unless they have the authority to act as an agent.
 - To determine if authority to act on behalf of the company exists we need to look to the common law of agency.
- Agency
 - Two parties can enter into a contract with each other in a situation where one of those persons is not directly involved in the actual process.
 - If an agent does not have authority, they may be liable to the principal or the third party.
 - Law of estoppel can come into play to enforce a contract.
- Assenting directly
 - Section 123
 - Provide that a company can have a common seal. This enables a company to enter a contract directly.
 - Section 127

- Use of the common seal if the company has elected to have a common seal and elects to use it for executing the document.
 - Section 127(2): A company with a common seal may execute a document if the seal is fixed to the document and the fixing of the seal is witnessed by:
 - (a) Two directors of the company,
 - (b) A director and a company secretary of the company; or
 - (c) for a proprietary company that has a sole director who is also the sole company secretary – that director.
 - Affixing of the seal is taken to be a corporate act which has an effect similar to the signature of an individual who is a party to a document: *Northside Developments Pty Ltd v Registrar-General* (1990) 170 CLR 146
 - The document is taken to be executed directly by the company itself.
 - For efficiency reason, trading corporations were allowed to enter contracts necessary in the ordinary course of their business without the need for affixing their seals: *Johnsons Tyne Foundry Pty Ltd v Maffra Corp* (1948) 77 CLR 544
- The other method does not require use of any seal.
 - Statutory method
 - Section 127(1) a company may execute a document without using a common seal if the document is signed by:
 - (a) two directors of the company
 - (b) a director and a company secretary of the company' or
 - © for a proprietary company that has a sole director who is also the sole company secretary – that director.
 - Company may adopt a constitution to include in it provision for other ways in which the company can execute a document – any provision does not exclude Section 127.
 - Pty company with only one director and no company secretary

Implied actual authority

- Authority
 - Actual authority
 - Implied actual authority (incidental or usual authority)
 - An agent is said to have implied actual authority in addition to any express grant of authority.
 - Apparent or ostensible authority
 - An agent may not have been given any actual authority, but nevertheless the principal has in some way made it appear to the third party that the person is his or her agent.
 - It may be that an agency relationship already exists between principal and agent based on a limited grant of actual authority, and the question is whether the agent has any apparent to act beyond those limits.
 - Authority by ratification
- Acquiescence
- Third party knowledge
 - There can be no authority where
 - The third party does not know of the representation or acquiescence.

- s 1324(1A) expressly gives creditors standing to apply for an injunction to prevent a share buyback or reduction of capital if the company is insolvent is an element of the contravention.
- Contravening the CA
 - A failure to observe other provisions in the Corporations Act than the replaceable rules is called 'contravention' of the Act.
 - Many provisions make contravention an offence. The penalty for breach is generally fine or imprisonment or both.
 - Schedule 3 – page 1685 of the Act.
 - Penalty unit as defined in subsection 4AA(1) of the Commonwealth Crimes Act as \$170. ASIC issues penalty notices for small breaches.
 - For other provisions it is stated that contravention is not itself an offence unless some other element is added.
 - Breach of director's duties (s181-183) is not a criminal offence unless the contravention is reckless or dishonest (s 184)
 - For some provisions contravention has civil consequences only.
- Civil penalty provisions
 - A civil penalty provision is a punishment for contravention, involving payment of an amount (a pecuniary penalty) up to \$200,000 which an individual can be ordered to pay.
 - The amount is paid to the Commonwealth as a result of ASIC taking a prosecution under the Act.
 - The proceedings are brought in a civil court, are subject to civil rules of procedure and evidence and the civil standard of proof.
 - Like a fine, a civil penalty is assessed by reference to the seriousness of the contravention rather than the quantum of loss or profits flowing from the contravention.
 - Provisions include:
 - Directors duties (s180-183)
 - Trading whilst insolvent (s588G)
 - Related party rules
 - Share capital transactions and financial assistance
 - Requirements for financial records and reports
 - Managed investment schemes
 - Insider trading
- Disqualification orders
 - Section 206C permits the court to disqualify a person from managing corporations for a particular period of time.
 - Particularly important where there have been breaches of directors' duties.
 - Can be imposed not only to protect members against further misconduct but also by way of punishment and general deterrence.
- Compensation orders
 - Section 1317H allows the court to order a person pay compensation where a civil penalty provision has been breached.
- Share capital reductions
 - Share capital reductions are an alternative to buy-back.
 - In buyback, the member has the option of refusing to sell, while in a reduction of capital, the members' shares can be cancelled against their will.
 - A reduction of capital may not necessarily involve a payment to members where shares are cancelled.
- Buyback procedure
 - S 256D(1) a company must not reduce its share capital unless it complies with the requirements of s 256B(1). These require that any reduction is
 - Fair and reasonable to the shareholders

- Does not materially prejudice the company's ability to pay its creditors.
 - Is approved by the shareholders under s256C.
- Why allow for share reductions?
 - A company may wish to undertake a reduction of capital to:
 - Return capital to members that is no longer required by the company
 - Cancel uncalled capital that is no longer required or
 - Cancel capital no longer represented by available assets.
- Equal share capital reductions
 - s 256B(2) Equal reduction – relates to every holder of ordinary shares in proportion to their shareholding and on the same terms for all shareholders.
 - Approval must be by ordinary resolution of company at GM – s 256C(1) plus s 256B(1)
 - s 256C(4) shareholders must be given all information known to the company that is material to the decision on how to vote.
- Selective reductions
 - This can allow shareholders to retire from the company (pty co) or for majority shareholders to consolidate their control or eliminate minority interests (public co).
 - Also a common part of schemes of arrangements where a company is in financial difficulty (but there is no winding up)
- Approval
 - If selective reduction, there must be either:
 - Special resolution at company GM with no votes cast in favour by any person who is to receive consideration.
 - Unanimous resolution by ordinary shareholders at company GM – section 256C(2)
- Fair and reasonable
 - A reduction of share capital must be fair and reasonable to the shareholders as a whole.
 - This includes between classes and groups of shareholders.
 - *Elkington v Costa Exchange Ltd* (2011) VSC 501
 - “Fair and reasonable” are one concept and include looking at a number of factors including:
 - Value of consideration paid for shares
 - Whether transaction needed for the company to grow
 - Whether needed to shareholders can exit the company
 - The court also needs to look at the interests of all shareholders.
- *Winpar Holdings Ltd v Goldfields Kalgoorlie Ltd* (2001) NSWCA 427
 - Company approved a selective reduction of shares via cancellation, and paid more for each share to the member whose shares are cancelled.
 - This was fair and reasonable allocation of benefits to all shareholders – majority got the benefit of 100% ownership and the minority shareholders got a higher price.
- Notification to creditors
 - s 256C(5) requires a company to lodge details related to a proposed capital reduction with ASIC to give creditors the opportunity to look at them.
 - Under the ASIC company Alert system – outsiders can set up and manage Company Alert profiles for the companies they want to monitor, and for the document categories they are interested in.
 - Emails are sent out overnight if companies lodge any of the document that have been nominated.
- Disclosure

- Diversion of corporate business
- Manipulation of voting power
- Group interests favoured over corporate interests (but note s 187)
- Failure to give access to corporate records combined 'with' running company for personal agenda and no meetings.
- Low dividends 'with' failure to review policy.
- Even though the conduct may accord with the company's constitution, it can be unfairly prejudicial: *Re Westbourne Galleries Ltd*, *Re Tivoli Freeholds Ltd*
- Relief can be given even if the conduct complained of does not involve a want of probity: *Re M Dalley & Co Pty Ltd*
- The fact that all members are treated uniformly as members does not necessarily make conduct fair: *Scottish Co-operative Wholesale Society Ltd v Meyer*
- Failure to act may constitute unfair prejudice: *Re Bright Pine Mills Pty Ltd*
- Past unfairly prejudicial conduct: *Re Kenyon Swansea Ltd*
- No relief where there are irreconcilable differences but no oppression: *Re a Company*
- Mismanagement does not constitute oppression: *Shirim Pty Ltd v Fesena Pty Ltd*

For the purpose of this Part, a person to whom a share in the company has been transmitted by will or by operation of law is taken to be a member of the company.

- **S 234** Who can apply for order
 - An application for an order under s 233 in relation to a company may be made by:
 - (a) A member of the company (NB s 231; s 234(a)(i) and (ii)), even if the application relates to an act or omission that is against:
 - (i) the member in a capacity other than as a member; or
 - (ii) another member in their capacity as a member; or
 - *Re Spargos Mining NL* (1990) 3 ACSR 1
 - *Trafalgar West Investments Pty Ltd v (as trustee for the Trafalgar West Investments Trust) v Superior Lawns Australia Pty Ltd (No 2)* (2013) 94 ACSR 151
 - The plaintiff held 30% of the shares when the action was commenced, and then transferred to its sole director but subsequently returned.
 - The court held that it was only temporary disenfranchisement, and allowed the plaintiff to continue.
 - *Ry Polyresins Pty Ltd* (1998) 28 ACSR 671
 - Supreme Court of Qld held that it was not possible for a controlling or majority shareholder in a company to be an applicant under the predecessor of Pt 2F.1.
 - The majority can eliminate the oppression anyway. But this would be different if they cannot.
 - *Mark v Roe* [1996] VSC
 - The minority can oppress the majority, in this case the minority included the managing director.
 - *International Hospitality Concepts Pty Ltd v National Marketing Concepts Inc (No 2)* (1994) 13 ACSR 368

- The minority can oppress the majority so as to entitle the latter to relief in appropriate cases.
 - (b) a person who has been removed from the register of members because of a selective reduction; or
 - (c) a person who has ceased to be a member of the company if the application relates to the circumstances in which they ceased to be a member; or
 - (d) a person to whom a share in the company has been transmitted by will or by operation of law; or
 - (e) a person whom ASIC thinks appropriate having regard to investigations it is conducting or has conducted into:
 - (i) the company's affairs; or
 - (ii) matters connected with the company's affairs.
- **S 233** Order the Court can make
 - (1) The court can make decisions that are appropriate in relation to the company.
 - (a) wind up
 - (b) constitution be modified or repealed
 - (c) regulate the conduct of the company

Pt 2F.1A – Proceeding on behalf of a company by member and others

S 236 – 242: statutory derivative action (replaces the general law)

- **S 236** Bringing, or intervening in, proceedings on behalf of a company
 - (1) A person may bring proceedings on behalf of a company, or intervene in any proceedings to which the company is a party for the purpose of taking responsibility on behalf of the company for those proceedings, or for a particular step in those proceedings (for example, compromising or settling them), if:
 - (a) the person is:
 - (i) A member, former member, or person entitled to be registered as member, of the company' or
 - (ii) An officer or former officer of the company.
 - (b) the person is acting with **leave granted under section 237**. (all five must satisfy)
 - (2) Proceedings brought in company's name.
 - (They don't get direct benefits, but the company does)
- **s 237** Applying for and granting leave
 - (1) A person referred to in paragraph 236(1)(a) may apply to the Court for leave to bring, or to intervene, in proceedings.
 - (2) The Court must grant the application if it is satisfied that:
 - (a) it is probable that the company will not itself bring the proceedings, or properly take responsibility for them, or for the steps in them; and
 - (b) the applicant is acting in good faith; and
 - Look at the motives of the applicant. applicant believes there is a good cause of action and there is reasonable prospect of success, and any collateral purpose: *Swansson v Pratt*
 - (c) it is in the best interests of the company that the applicant be granting leave; and
 - Company's interest rather than shareholders or directors. The Court will form its own view. The Court must be satisfied