

CORPORATIONS LAW SCAFFOLD

History and Theories

Company: distinct legal entity with separate legal personality. Organizational structure that facilitates the raising of finance for business activity. ~98% are smaller proprietary.

Concession Theory: early English history, government was prepared to give businesses a charter to do something, granting them a *privilege* → heavy regulation

Aggregate Theory: corporations just like partnerships. Constitutional right to get together and do business.

Social Entity Theory: early 1900s in US, big biz getting funds from upper/middle class → divide between ownership and control. Brought regulatory implications into focus as well as CSR.

Nexus of Contracts Theory: 1980s response to perceived over-regulation. Corporation is simply a matrix of contracts b/w economic agents

Team Production Theory (UCLA): S/H give the board wide discretion to allocate resources.

History Anglo-Australian corporations law: Boroughs and guilds → incorporation by royal charter (state feared power of corps. so only gave legitimacy to those with royal charters) → Incorporation by private Act of Parliament → rise of the joint-stock corporation/de facto incorporation (essentially a black market of companies – large partnerships that held property on trust) → South Sea Bubble and *Bubble Act 1720*: designed to outlaw joint-stock companies = market downturn. On books for 105 years but never enforced (repealed 1825) → *Joint Stock Companies Registration and Regulation 1844* gave registered joint stock companies separate legal personality, but not limited liability → *Limited Liability Act 1855* granted s/h limited liability → Uniform Companies Acts 1961/62 → National companies Bill died with Whitlam government in 1975 → *Corporations Law 1989* cross-vesting to enforce → following challenges to cross-vesting legitimacy (*Re Wakim; R v Hughes*) *Corporations Act 2001*

Chief Regulatory Bodies: ASIC, ASX listing Rules, Takeover Panel, Corporations and Market Advisory Committee (CAMAC), Australian Accounting Standards Board (AASB), Financial Reporting Council (FRC).

1.0 Classification of Corporations

1.1 Types of Liability and Size

Section 112 - Classifications	
<p>Proprietary (s45A)</p> <ul style="list-style-type: none"> Limited by shares or an unlimited company with a share capital No more than 50 non-employee S/H (s113) <p>Small Proprietary – satisfies at least 2 (s45A) → Large Prop. is = or greater than below (s45A(3))</p> <ul style="list-style-type: none"> Consolidated revenue for fin year incl. controlled entities <\$25m (45(2)(A)) Consolidated gross assets + cntrld <\$12.5m (.2.b) Company+cntrld <50 employees (.2.c) <p>Directors required: 1 ordinarily resides in Aus (s201A1)</p>	<p>Limited by shares: liability of members is limited by amount left <u>unpaid</u> on their shares (s9)</p> <p>Unlimited with share capital: Basically unlimited liability for s/h → only a handful remain</p>
<p>Public (s9) – anything not proprietary, but not all are listed.</p> <p>Directors required: 3, not including alternate directors, and 2 ordinarily residing in Aus (s201A2)</p> <p>Registration requirements for both (s117)</p>	<p>Limited by shares: above</p> <p>Limited by guarantee: limited by respective amounts they guarantee in case of bankruptcy (s9) do not raise share capital, cannot apportion profit if made.</p> <p>Unlimited with share capital: above</p> <p>No liability company: only public and mining only – by constitution; mining purposes only (s112(2)(b))</p>

Subsidiary: another body; controls the composition of the body's board, is in a position to cast or control casting of more than ½ the maximum number of votes at a general meeting of the board, holds more than ½ issued share capital of board OR the body is a subsidiary, of a subsidiary of the other body. (s46)

Pros of incorporation: limited liability, free transferability of shares (prima facie), separate legal personality and centralized management, perpetual existence and greater ability for fundraising

Cons: regulations and monetary costs

2.0 Corporate Personality and Limited Liability

Limited liability pros: unfair to be liable for actions of corporation if you're a passive investor, free transferability of shares, efficiency of capital markets, portfolio diversification, benign risk-taking, capital raising, creditors better risk bearers. **Cons:** moral hazard (undue risks), theoretically shelter risky parts of biz in under-capitalised subsidiaries, the benefits are nullified in closely-held corporations/subsidiary corporations.

2.1 Separate Legal Personality

Prima facie, a corporation is separate from its owners (*Salomon*) Mere fact that someone is a director of a company is no impediment to his entering into a contract to serve the company (*Lee v Lee's Air Farming Ltd*)

Piercing the Corporate Veil: The exposed person is the shareholder (no benefit of limited liability). Statutory piercing is towards exposing directors rather than shareholders. The examples are neither exhaustive nor exclusive:

- Fraud or improper conduct:** 'mere cloak or sham' to commit breaches of the restrictive covenant, created for the purposes of evading an **existing** legal obligation (*Gilford Motor Co Ltd v Horne*) c.f. **future** obligations (*Lee*). Extended to include companies **acquired** to evade existing legal obligations (*Jones v Lipman*), intention at the point of incorporation is critical (*Pioneer Concrete*)

2. Agency	
To Pierce	Not to Pierce
Parent is in effectual and constant control of a WOS	If WOS owns the land, difficult to say that parent was in fact carrying on the business (<i>DHN Food Distributors Ltd</i>)
(1) Were the profits treated as profits of the parent company? (2) Were persons conducting the business appointed by the parent company? (3) Was the parent the head & brain of the trading venture? (4) Did the parent govern the venture, decide what should be done and what capital should be embarked on the venue? (5) Did the parent make the profits by its skill and direction? (6) Was the parent in effectual and constant control? (<i>Smith Stone and Knight</i>) – <i>Atkinson J</i>	SAMPLE
(7) Subsidiary capable of standing on its own, or undercapitalized to the extent it was on a drip feed? (<i>Re FG (Films) Ltd</i>)	
Vertical Integration (<i>DHN Food Distributors</i>)	Horizontal Integration (firms working together) (<i>DHN Food Distributors</i>)

- Corporate Groups:** ownership of business, land and operating vehicles used in a single business operation were divided between three companies in a wholly owned corporate group → essentially a **partnership** (*Denning* in *DHN Food Distributors*). Factors in favour: (1) subsidiary(s) wholly-owned, (2) subsidiary(s) has no separate business operations, (3) question – **whether the owners of the business had been disturbed in their possession and enjoyment of the business.**
 - In the absence of some contract creating some additional right, the creditors of Company A, a subsidiary company within a group, can **only** look to that company for payment of their debts (*Mason J*). When ascertaining the amounts of profits available by distribution by way of dividend, it is **correct** to look at the profit of the holding company **only** and **not** the group (*Industrial Equity*)
- Contract Cases:** Generally, if you contract with one of the members of the group, you cannot impose liability on the other group companies (*Quintex*). Contractual promise in a deed executed by a subsidiary company, **cannot** be imputed to its parent company (*Pioneer Concrete Services*). Suggestions by *Roger CJ* that law reform required to aggregate assets – desirable for lazy creditors who don't do D.D., undesirable for prudent creditors whose investment in a strong profit-engine is sucked up by poorly performing subsidiaries
- Tort Cases:** Where subsidiary is a tortious creditor, its parent **may** also be liable. More appropriate as a tort creditor cannot choose the tort-feasor. An employee who cannot negotiate working conditions (**vulnerability**) more likely a tort creditor rather than contractual (*Briggs v James Hardie & Co Pty Ltd*)
- Parent controls employment conditions of subsidiary** (not veil piercing as **direct duty of care**) – (*CSR Ltd v Wren*)
- Vicarious liability:** employer liable for acts of employee within scope of employment – being a nominee director for a subsidiary **could** mean you were acting for the parent (*Dairy Containers Ltd v NZI Bank Ltd*)

5.0 Binding the Corporation

Act **of** the company: where a corporate organ contracts in the name of the company.

Act **for** the company: contracting through an agent.

5.1 Capacity

Historically, companies were required to state their objects in the memorandum of association, any conduct outside was *ultra vires* and strictly void.

Now, a company has the **legal capacity and powers of an individual** both in and outside this jurisdiction (s124(1)).

Company has all powers of a body corporate; | issue and cancel shares | issue debentures | grant options over unissued shares | distribute company's property among members | grant a security in uncalled capital | grant a circulating security interest over company's property | arrange for company to be registered or recognized as body corporate outside jurisdiction | do anything authorized by any other law (including foreign) | (s124(1) a-h)

A company's legal capacity to do something is **not affected** the fact that the **company's interests** are not, or would not be served by doing it (s124(2)) No power to do anything prohibited by law (s124(3))

A company's corporate constitution **can limit** the company's power (s125) however, a breach of an express restriction/prohibition does not render the exercise invalid (s125(1)), nor is an act contrary to its objects invalid (s125(2)). Though a breach internally, the continuing validity protects the interests of third parties.

5.2 Authority to bind the corporation

Company can either contract **as a company** (s127(1)) or **through an agent** (s126) – 'express or implied authority'

Contracting by corporate organs (s127)

Company may execute a document **without using a common seal** if the document is signed by; (a) 2 directors or (b) a director and a company secretary (c) proprietary where director = secretary, that director (s127(1))

Company **with a common seal** may execute if seal is fixed and fixing of seal witnessed by; (a) – (c) above (s127(2))

Contracting by agent (s126)

Company power to make, vary, ratify or discharge a contract may be exercised by an individual acting with the company's **express** or **implied** authority and on behalf of the company – common seal unnecessary. (s126).

An act outside their authority is not *ultra vires*, the act is **voidable**.

Authority at common law

- **Express** actual authority: principal has expressly consented to the agent acting on its behalf (resolution or employment contract? → look at constitution first)
- **Implied** actual authority: inferred from conduct of the parties and circumstances of the case.
 - **Usual implied** authority: nature of the office
 - **Acquiescence by the actual authority holder**: acquiesced to the unauthorized exercise of power → based on a course of conduct by the principal.

No usual implied authority by position as chair to enter into loan guarantee contracts (**Brayhead**) – query whether since 1968 this position has changed (**ASIC v Rich – Austin J**)

No actual authority/implied authority by position as an individual director to enter such contracts (requires board consent as a whole). However, where a director acts as a de facto managing director and the other directors have acquiesced (evidence required) to this conduct, implied actual authority may be made out (**Brayhead**)

The office of company secretary will have **actual implied authority** to enter into such contracts as ordering a number of hire cars (**Fidelis**)

If the corporate constitution expressly limits the powers exercisable by certain people, you **cannot** infer they possess actual implied authority **usual to that office**, however, if the **relevant authority holder** (who has **actual** authority, this person cannot be restricted by the corporate constitution – **Crabtree**) acquiesces and that original person continues to exercise power, then that specific individual will own actual implied authority – **Freeman and Lockyer**

- **Ostensible or 'apparent'** authority: All about **appearance**, 'looks like' a person has power to do to the outside. 'armed with title, status and facilities' by those with actual authority to make it look like the representor has actual authority' (**BNP Paribas**)

Four requirements; (**Freeman and Lockyer – Diplock LJ**).

- (i) a **representation was made** that the agent had authority to enter into that type of contract – representation **need not be positive**, acquiescence is sufficient,
- (ii) the representor **had actual authority to act** on behalf of the company either generally or in the specific matter → NOT ostensible authority. see (**Crabtree**), where the representor's power was restricted by the corporate constitution and thus had no actual authority.
- (iii) **reliance on this representation**,
- (iv) company is **not deprived by its constitution of the ability** to delegate authority to an agent.

6.5 Insolvent Trading Duties

S558G

A director (X) will be personally liable if a company: incurs a debt AND X is a director at the time of incurring the debt AND the company is insolvent OR there are reasonable grounds for suspecting it is insolvent AND X is aware at the time that the debt is incurred that there are reasonable grounds for suspecting the company is insolvent or a reasonable person in X's position would be so aware.

- Subjective state of mind is irrelevant for determining suspicion of insolvency. Objective test looking at the circumstances (*Metropolitan Fire Systems*)
- Reading of financial statements is insufficient to defend oneself. Couldn't raise the defence on reasonable grounds because the D hadn't read the financial statements carefully enough (*CBA v Friedrich*)
- Incurs a debt: an obligation to pay an ascertained liquidated sum – strict legal meaning (*Hawkins v Bank of China*). A guarantee may fall under this depending on its construction. It will be incurring a debt even if it's a contingent liability.

Cash Flow Test (s95A) A person is solvent if and only if the person is able to pay all the person's debts as and when they become due and payable.

A temporary lack of liquidity will not constitute insolvency. The court will take into account all of the (realizable) assets, and extensions of time to payback liabilities (*McLellan in the matter of the Stake Man Pty Ltd v Carroll*) → can be insolvent on a cash flow basis even though you have a lot of assets.

Reasonable ground for suspecting insolvency

Metropolitan Fire Systems Pty Ltd v Miller

- Objective, rather than subjective standard.
- Only thing needed are 'alarm bells'
- Passive directors who weren't involved or paying attention are more easily caught out by this (*CBA v Friedrich*)

Defences to liability

S588H(2) - Reasonable grounds to expect, and did in fact expect that the company was solvent at the time of incurring the debt

- Defence can only apply if there were **no reasonable grounds to suspect** the company was **insolvent** and it just turned out that it actually was (at the time of incurring the debt). → expectation > suspicion (more than a hope).

S588H(3) - Reasonable reliance on information that the company was solvent **from a competent and reliable person** who was responsible for providing information to the director.

- Although seemingly a wide safe harbor to pass on responsibility, in reality, it seems to require ongoing monitoring and review, and won't protect passive directors acting without scrutiny.
- Director (X) argued he was exculpated as he relied on info presented by an accountant/financial advisor about solvency. The defence was not upheld. This person was a more general accountant/advisor and not a person responsible for providing information to the director. His opinion was only based on info provided by the company. The advisor must have good, and possibly independent, information (*McLellan in the matter of the Stake Man Pty Ltd v Carroll*)

S588H(4) - Justifiable non-participation (director was ill when board meeting to approve incurring debt occurred)

- Not justifiable non-participation for a wife to say she is a non-participating director of a small proprietary company (*Deputy Commissioner of Taxation v Clark*) – also can't just argue that you're not good with financials etc.
- Not 'good reason' to not take part in the management of the company because a director was excluded from the management by the deceptions of the other directors (*Tourprint International P/L v Bott*)

S588H(5)-(6) - All reasonable steps taken to prevent the incurring of the debt

In earlier cases, the creditors could bring this enforcement action and get damages. Now the liquidator can enforce the claim against directors on behalf of the company. Moreover, this is a civil penalty provision so either ASIC or the company can bring proceedings.

Holding company liability

S588V – Parallel insolvency trading provision such that if a debt is incurred whilst a subsidiary is insolvent, the **parent company** is liable.