

LAWS 200
BUSINESS ORGANISATIONS

(Lectures with Ram Pandey)

Student's Lecture and Study Guide

AUSTRALIAN CATHOLIC UNIVERSITY
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LAWS 200 – Business Organisations
(Lectures with Ram Pandey)

WEEK 1

Nature of Companies and the Australian Regulatory Framework

Company Law

- Company law is that branch of the law governing the creation, operation and regulation of companies and those who operate or deal with them.

Company / Corporation

- A *corporation* (or *body corporate*) is a legal device by which legal rights, powers, privileges, immunities; and duties, liabilities and disabilities may be attributed to a fictional entity equated for many purposes to a natural person.
- Generally, when used in the Corporations Act, the term *company* means a company registered under the Act (s 9). Companies originally had to have more than one member; however, a single member company can now be formed (s 114). A company comes into being when the Australian Securities and Investments Commission respond to an application for the registration of a proposed company. When ASIC registers a proposed company the company comes into existence as a body corporate at the beginning of the day on which it is registered (s 119). It remains in existence until it is deregistered under Chapter 5A.
- A company is generally a type of voluntary association of individuals or corporations for a common purpose. People may associate for a variety of reasons, including for financial gain. Provided that their association is for a lawful purpose, the Corporations Act facilitates this association through the use of a company
- Corporation meaning (s 57A)
 - (1) Subject to this section, in this Act, *corporation* includes:
 - (a) a company; and
 - (b) any body corporate (whether incorporated in this jurisdiction or elsewhere); and
 - (c) an unincorporated body that under the law of its place of origin, may sue or be sued, or may hold property in the name of its secretary or of an office holder of the body duly appointed for that purpose.
 - (2) Neither of the following is a *corporation*:
 - (a) an exempt public authority;
 - (b) a corporation sole.
 - (3) To avoid doubt, an Aboriginal and Torres Strait Islander corporation is taken to be a *corporation* for the purposes of this Act.

Advantages / Functions

- Companies can be used to conduct various types of lawful activity (including for profit)
 - XPT: trade unions cannot be registered as Corporations Act companies (s 116)
- Limiting the liability of members
 - XPT: it is possible to have an unlimited company
- Co-ordinating participants in a large enterprise
- A nominee to hold legal title to assets
- A structure for a joint venture
- A structure for a fund management
- Providing a regime for the co-ownership of property

Disadvantages

- the company's directors and management are regulated under the Corporations Act (and directors may still face personal liability in certain circumstances)
 - the company is required to disclose certain information to ASIC
 - registration involves paying initial and ongoing fees
 - the company sometimes must consider the interests of creditors
- Most business people find advantages (particularly limited liability) outweigh disadvantages.

OTHER BUSINESS ORGANISATIONS

1. *Sole proprietorship*

A sole proprietorship is an individual personally conducting their own business (also known as a sole trader). Although not really a 'form' of business organisation, the concept of a sole trader is well established in commercial circles. There are no mandatory procedures to follow to establish a business as a sole trade. No specific legislation regulates the formation of a business as a sole trader. However, certain registrations will be required: Business Name, Australian Business Number (ABN), Goods & Services Tax (GST). Note: A sole trader is taxed as an individual income earner.

Advantages:

- Sole trader has complete ownership & control of business
- Sole trader may keep all the profits they make
- Lack of formalities, although accounts will have to be kept for tax purposes
- Nature of the business can be easily changed (nothing can be challenged as being ultra vires)
- Maintenance of secrecy (do not need to lodge documents with ASIC)

Disadvantages:

- Unlimited liability for all debts of the business
- Personal liability – Sole trader's personal assets, not just the assets of the business, are at risk. Unlimited personal liability for:
 - the debts of the business
 - injuries caused/compensation payable by the business
 - fines incurred by the business
 - All personal assets at risk, not just those used in the business (although some insurance is available)
- Death/retirement of the sole trader will usually mean the end of the business
- Personal goodwill makes it difficult to sell the business
- Individuals may - Lack management skills or expertise → Have difficulty raising large amounts of capital

2. *Trading Trust*

A trust is a term used to refer to an arrangement: where a person (trustee) is required to manage property (the subject matter of the trust) for the benefit of others (the objects or beneficiaries). Trust is a creation of equity. Despite some statutory modification, the rules of equity still apply to their creation, management and enforcement.

Trusts can be established for private or public (charitable) purposes – private trusts can only last for a limited time, while public trusts can last indefinitely

Beneficiaries – have beneficial or 'equitable' interest in the trust property (i.e. it is held for their benefit) – have the right to apply to court if they feel the trustee is not following the directions of the trust deed (the document that set up the trust)

Trustee – 'legal' owner of the trust property or subject matter, but has 'equitable' duty to manage it for benefit of others – has heavy responsibilities (under trust deed and general law) but generally not entitled to remuneration for services (some exceptions). A trustee can be a person or a company. A trustee must adhere to the trust deed, but if the terms are impossible to carry out, the trustee can apply to the court for direction. Trustees act as a fiduciary (avoid conflicts of interest)

Trust as compared to Companies:

- Public unit trusts are not subject to restrictions on size of associations for gain in s 115 (more than 20)
- Beneficiaries have no inherent power to meet and give directions to the trustee on how to administer the trust, in contrast with shareholders who may control a company unless the constitution or the Corporations Act restricts them from doing.
- A trust, unlike a company, is not a separate legal entity
- If a trustee incurs a debt on behalf of the trust, the debtor to whom the creditor must ordinarily look, is the trustee – Creditors sometimes may limit their claims to trust assets; and – A trustee may have a right to be indemnified out of trust assets under the terms of the trust deed. In contrast, if a director incurs a debt on behalf of a company, generally the creditor can only look to the company (although there are cases where directors may be personally liable for debts e.g. personal guarantees or insolvent trading).
- There cannot be a single person trust, but there can be a single member, single director company
- Trustees cannot be indebted to themselves, but directors can be indebted to their companies
- Trusts cannot sue (the proper plaintiff is the trustee or in some cases the beneficiaries), but companies, as separate legal entities can sue and be sued
- Private trusts can be created without applying to ASIC, unlike Corporations Act companies

3. *Partnership*

It is the relation which subsists between persons carrying on a business in common with a view of profit - *Partnership Acts* and *Pooley v Driver* (1876) 5 Ch D 458

- *general partnership* - all partners are liable for all the partnerships debts
 - *limited partnership* - has general and limited partners
 - *general partners* manage the business and are subject to unlimited liability
 - *limited partners* do not take part in management and are only liable to the extent of their contribution
- (See Week 12 for more about partnerships)

4. Joint ventures

It is where parties are participating in a single project together. 'The term "joint venture" is not a technical one with a settled common law meaning – As a matter of ordinary language, it connotes an association of persons for the purposes of a particular trading, commercial, mining or other financial undertaking or endeavour with a view to mutual profit, with each participant usually (but not necessarily) contributing money, property or skill – Such a joint venture (or, under Scots' law, "adventure") will often be a partnership – The term is, however, apposite to refer to a joint undertaking or activity carried out through a medium other than a partnership: such as a company, a trust, an agency or joint ownership.' (United Dominions Corp Ltd v Brian Pty Ltd (1985) 157 CLR 1, 10)

There is a risk that a joint venture may be held to be a partnership and so sometimes a company is used as a joint venture vehicle. According to Crennan J in *Gibson Motor Sport Merchandise Pty Ltd v Forbes* [2005] FCA 749, [80], recognisable and common characteristics of joint ventures include:

1. Participants hold proprietary interests in the assets of the joint undertaking, often, but not necessarily, as tenants-in-common;
2. Participants exercise joint control of the undertaking;
3. Participants contribute to the joint undertaking, not necessarily equally; such contributions may be disparate: *Canny Gabriel Jackson Advertising Pty Ltd v Volume Sales (Finance) Pty Ltd* (1974) 131 CLR 321, 327
4. Participants in the joint undertaking enjoy rights and assume obligations, which are often several, and calculated by reference to ownership of shares and/or contributions made.
5. Participants have a joint (or community of) interest in the performance of the undertaking's purpose: *Cummings v Lewis* (1993) 41 FCR 559;
6. Participants associate in the undertaking for mutual commercial gain which can be mutual profits

Unincorporated mining joint ventures in the mining and petroleum industry feature several companies contracting: – to work together to in operating a mine or a well; but – on terms that each party will sell its share of the mineral or oil separately. They are structured to avoid being partnerships. Distinctions which can be made between a joint venture and a partnership are not always simple or without controversy (Crennan J in *Gibson Motor Sport Merchandise Pty Ltd v Forbes* [2005] FCA 749, [78])

Management can be through: – committee with representatives from each joint venturer – a specially formed company in which joint venturers hold shares (sometimes called a JV vehicle). Each party continues to engage in its own separate, preexisting business.

Fiduciary obligations do not automatically arise. However, the actual terms of the joint venture agreement may produce a fiduciary relationship between the parties (*Thomas v SMP (International) Pty Ltd* (No 4) [2010] NSWSC 984, [67]-[70])

Liability will depend on the terms of the JV/contract signed – Liability for debts may be joint and several – Participants are not automatically liable for the acts of their fellow joint venturers – However, they may agree to share specified liabilities. Taxation will depend on the terms of the JV – Gross income, rather than profit, may be shared under the joint venture (e.g. unincorporated mining JV) – Where income is received by the participants jointly, they will be partners for taxation purposes.

5. Co-operatives

International Co-operative Alliance (ICA) defines a co-operative as 'an autonomous association of persons united voluntarily to meet their common economic, social and cultural needs and aspirations through a jointly-owned and democratically-controlled enterprise'. Co-operatives are traditionally based on values of self-help, self-responsibility, equality and solidarity

Co-operatives are distinguished from other forms of organisation by:

- their democratic structure;
- the fact that capital is used to service the common needs of the members, rather than to provide individual benefit;
- they operate according to internationally agreed co-operative principles developed by the ICA
- all members have equal status and voting rights;
- no member can hold more than 20 per cent of shares;
- all active members can nominate as directors and elect directors; and
- capital is used for the group's common interest

Advantages and disadvantages:

- Members of a co-operative:
 - can benefit from economies of scale through the combined purchasing, distribution or marketing power or influence of the group;
 - can share in the group's investment and operational risks and losses, as well as its benefits
- Contrast: Unlike private companies,
 - co-operatives do not have a limit on membership numbers
 - Their 'one member, one vote' system also differs from public companies, where voting rights are linked to share ownership
 - The name of a registered co-operative always includes the word 'Co-operative', 'Co-op' or 'Coop' and ends with 'Limited' or 'Ltd'

2 Types:

Co-operatives: – can be involved in a variety of social and commercial activities; and – may carry out any activity defined within its rules • Co-operatives can be established as either: – Distributing; or – Non-distributing

- *Distributing*: May distribute any surplus funds to its members • Must have share capital and at least 5 active members • If less than 5 active members wish to form a co-operative, permission must be obtained from the Registrar • Can distribute part of its surplus to members by way of bonus shares, dividends or rebates • When formed, each member must buy the minimum number of shares stated in the co-operative's rules • Members receive a return on the capital they invest if the co-operative is wound-up
- *Non-distributing*: Will use surplus funds to support its activities • Likely to be more appropriate for a community organisation • Must also have at least five active members, but must not distribute surpluses to members • Can have share capital, but do not have to • Members can only get back, at most, the original value of their shares in the co-operative's capital if the co-operative is wound-up

4 Categories:

1. Consumer – Buying and then selling goods to members at a competitive rate;
2. Marketing – branding, marketing and distributing members' products and services;
3. Service – providing services to members, such as health, electricity or housing;
4. Community – resource, information and skill sharing, encourages ownership and participation

6. Non-profit organisations

An association includes any group of persons who have agreed to join together in the pursuit of one or more common objects or purposes (Smith v Anderson (1880) 15 Ch D 247). If the group's common purpose does not include the direct acquisition of profit for members, it will not be a partnership • Non-profit organisations may be unincorporated or incorporated.

People associate for reasons other than conducting a business e.g. social and sporting clubs. for education, school, a social club, student association, a charity, Society of St Vincent de Paul. Many of these associations are unincorporated. Associations incorporation legislation in each of the States and Territories allows non-profit organisations to limit the liability of their members by incorporation.

The main advantage of an unincorporated association is that it is easy to form.

The disadvantages of an unincorporated association are:

- it is not a separate legal entity (Leahy v Attorney-General (NSW) (1959) 101 CLR 611, 619; Watson v J & AG Johnson Limited (1936) 55 CLR 63, 67-68) and therefore:
 - it cannot own property or sue in its own name;
 - committee members may be personally liable; and
 - it only lasts as long as there are members (no perpetual succession)
 - reliant on membership fees and donations

Members of an unincorporated non-profit association are not liable merely by reason of their membership for debts incurred by the persons who manage the association's affairs and enter into contracts on their behalf (Freeman v McManus [1958] VR 15). However, where committee members acting within their authority have entered into a contract purportedly on behalf of the association, they will be personally liable to the party that they made the contract with (Bradley Egg Farm v Clifford [1943] 2 All ER 378)

Non-profit Organisations vs a company:

- a company is created under the Corporations Act and is subject to that Act as to its formation, constitution, management, winding up and dissolution;
- the regulatory requirements for a company such as periodical reporting to the regulator are more extensive
- because there is a national system of administration under the Corporations Act a company can do business anywhere in Australia without further registration; and
- a company structure is available whether the group purpose is the gaining of profit or not

Origins of Companies (HISTORY)

Corporation sole

- common law corporations sole originated in the Middle Ages in connection with the holding of title to Church land by ecclesiastical office holders. common lawyers treated the occupant of the office and his successors as an artificial person in which title to Church property could vest and the corporation still existed even though there was a vacancy in the office
- In *Trustees of the Roman Catholic Church v Ellis* it was held that the Roman Catholic Archbishop of Sydney was not a common law corporation, a corporation sole under Crown grant or a statutory corporation sole.
- the Crown is treated as a corporation sole.
- A corporation sole is an incorporated series of successive persons. Corporations sole are distinct from companies with one member. A single member company is a corporation aggregate because it can become an association by acquiring more members.

Corporation aggregate

- A corporation aggregate is an incorporated *group* of co-existing persons or an incorporated single person with whom others could associate.
- It has been found necessary, when it is for the advantage of the public to have any particular rights kept on foot and continued, to constitute artificial persons, who may maintain a perpetual succession, and enjoy a kind of legal immortality. These artificial persons are called bodies politic, bodies corporate (*corpora corporata*), or corporations.
- Medieval English law found it necessary to treat certain groups as having a separate legal existence that would survive the individuals comprising them. Boroughs and colleges were endowed with this personality and were called *corporations aggregate*. In England, corporations aggregate could not arise spontaneously, they had to be created by Royal Charter.

Statutory corporations

- In England, from the 1500's, Parliament could create a corporation. The Commonwealth and State Parliaments have the power to create corporations and to authorise a regulatory authority to grant it

Joint stock companies (associations)

- Commercial developments in the 1700's made it necessary to raising of large sums of capital including from the public. Large quasi-partnerships known as *joint stock companies* were formed where parties could not obtain a Royal Charter or Act of Parliament
- "Company" here means association. Joint stock companies were unincorporated associations
- To attract investment, the promoters had to arrange for shares to be readily marketable. Membership shares were issued on terms that they were transferable without the consent of other investors in the company.

Deed of settlement companies

- Deed of settlement companies (partnerships) arose under which a few of the partners named in a deed were appointed trustees to conduct the business of the association on trust for the other partners in accordance with terms set out in the deed
- The *Joint Stock Companies Registration and Regulation Act 1844* (UK) took over the deed-of-settlement company. It made it a statutory incorporated creature generally available on presentation to the Registrar of Joint Stock Companies of prescribed papers and payment of certain fees
- Incorporation does not necessarily mean that the members of the corporation are free from personal liability for the corporation's debts

Limitation of liability

- The 1844 Act did not exclude the personal liability of members for company debts but creditors had to exhaust their remedies against the company first
- The *Limited Liability Act 1855* (UK) gave persons forming a company the option of forming it on the principle that the liability of the members would be limited to what they agreed to contribute to the company.

Evolution of modern company - Companies Act 1862 (UK)

- Following almost 20 years of reform since the 1844 Act the ultimate outcome was the consolidation of English company law in the *Companies Act 1862* (UK). Australian companies legislation descends from it.

Australian Company law

- Before Federation, Australian colonies had company legislation based on *Companies Act 1862* (UK)
- The Commonwealth did not take over after Federation as it was not given plenary power to legislate with respect to corporations. This prompted moves for the States to refer legislative powers in this area to the Commonwealth as contemplated by s. 51(xxxvii) of the Constitution

The Corporations Act 2001 (Cth)

- As from 15 July 2001 the *Corporations Act 2001* (Cth) and the *Australian Securities and Investments Commission Act 2001* (Cth) became the legislation governing corporations and securities in Australia
- The provisions of the old Corporations Law of the 1991 scheme were re-enacted in the Corporations Act but with such changes as were needed to reflect the fact that there would no longer be a separate Corporations Law for each State and the Northern Territory
- One of the most recent amendment is the *Corporations Amendment (Improving Accountability on Director and Executive Remuneration) Act 2011* (Cth) – Strengthened the non-binding vote on the company's remuneration report by requiring a vote re-elect certain directors if they do not adequately address shareholder concerns on remuneration issues over two consecutive years.

AUSTRALIAN REGULATORY FRAMEWORK

The main features of regulation of companies in Australia are:

- prescription by the Commonwealth legislature of the conditions for the formation, operation and winding up of companies;
- registration of companies by ASIC;
- maintenance by ASIC of registers open to the public containing significant information about companies and persons connected with them;
- policing by ASIC of the legislative prescriptions;
- exercise by ASIC of discretions conferred on it by the legislature to grant exemptions from prescriptions or to vary them;
- publication by ASIC of information about the exercise of its discretions and its policies and procedures;
- supervision of the winding up of companies by the superior courts

Why regulate?

- To provide information
 - people need to know that they are dealing with people authorised to act on its behalf
 - they also need to know how to sue a company that breaches its legal obligations
- To set standards for corporate governance
 - community has an interest in excluding people with records of dishonesty from company management
 - checks and balances on corporate management are also needed particularly in listed companies
- To regulate capital markets
 - offerees need to be informed about the risks associated with investing in certain companies
 - requiring disclosure of relevant information for listed companies helps keep the market efficient and fair
- To regulate the market for corporate control
 - these protect shareholders who are less informed and help to prevent them from disposing of shares without adequate information or a chance to share in a premium for control of the company
- To regulate the securities industry
 - regulation of the trade in company securities (e.g. shares) sets standards of honest dealing and prevent market manipulation and insider trading
 - requiring those who provide investment advice to be licensed helps to protect the public from unscrupulous advisers promoting the sale of shares in companies of dubious value

Australian Securities and Investments Commission (ASIC)

- ASIC is Australia's corporate, markets and financial services regulator
- It is an Independent Commonwealth Government body
- It is set up under, and administers, the *Australian Securities and Investments Commission Act 2001 (Cth)* (ASIC Act)
- Most of its work is carried out under the *Corporations Act 2001 (Cth)* (Corporations Act)
- ASIC contributes to Australia's economic reputation and wellbeing by ensuring that Australia's financial markets are fair and transparent.
- ASIC's regulatory remit is broad and includes:
 - companies and businesses
 - financial markets
 - financial services organisations
 - professionals who deal and advise in investments, superannuation, insurance, deposit taking and credit
 - external administrators e.g. liquidators

Criminal and Civil Liability

- A failure to observe a provision of the Corporations Act is referred to as a *contravention*
- Some contraventions are also *offences* - an *offence* is a contravention punishable by the criminal sanctions of imprisonment or fine (pecuniary penalty). For example, a person who contravenes s 1043A ("insider trading") whilst knowingly in possession of non-public price-sensitive information thereby commits an offence, punishable by imprisonment or a fine or both
- A civil penalty is a punishment for contravention, involving payment of an amount (a *pecuniary penalty*) of up to \$200,000, which the court orders the defendant to pay. The amount is owing to the Commonwealth and payable to ASIC on the Commonwealth's behalf, and is treated as a civil judgment debt: s 1317G. The civil penalty provisions are found in s. 1317E of the Corporations Act.

Other consequences

- The effect of a failure to comply is that a transaction is void or voidable
- For example, s. 259C:
 - the issue or transfer of shares of a company to an entity it controls is void, subject to exceptions,
 - but it does not seek to prohibit anyone from purporting to issue or transfer shares in those circumstances

WEEK 2
Incorporation, Corporate Personality and the Separate Legal Entity Doctrine
Types of Companies
Registration and Setting Up a Company

Incorporation

- To register a company, a person must lodge an application with ASIC (s 117)
- A company comes into existence as a body corporate (is incorporated) at the beginning of the day on which it is registered (s 119)
- The company's name is the name specified in the certificate of registration (s 119)
- If an application is lodged under section 117, ASIC may:
 - (a) give the company an ACN; and
 - (b) register the company; and
 - (c) issue a certificate that states:
 - a. the company's name, ACN and type;
 - b. that the company is registered as a company under this Act; and
 - c. the State or Territory in this jurisdiction in which the company is taken to be registered; and
 - d. the date of registration s 118

Corporate personality

- A company has the legal capacity and powers of an individual (s 124(1))
- A company also has all the powers of a body corporate, including (among other things) the power to:
 - issue and cancel shares in the company;
 - issue debentures
 - grant options over unissued shares in the company;
 - distribute any of the company's property among the members, in kind or otherwise ss 124(1)(a)-(d)
- A company limited by guarantee does not have the power to issue shares s 124(1)

Common law powers

By the late 1700's corporations had acquired various powers at common law including:

- to sue or be sued in the corporate name;
- the ability to take in new members until it was dissolved (perpetual succession)
- to have a common seal to show assent;
- to hold property; and
- to make its own internal governance rules

Statutory powers

The old s 123(2) of the Corporations Law specified that a company could:

- perform all the functions of a body corporate;
- sue and be sued;
- enjoy perpetual succession;
- acquire, hold and dispose of property, and should have a common seal.

NOW:

- The current Corporations Act states that a company has the powers of an individual and a body corporate s 124
- A company is no longer required to have a common seal, but it may do so s 123

POWER TO SUE AND BE SUED

- Generally a company any cause of action available to natural persons, whether in tort, contract or otherwise, is available to a company
- However, a company is only entitled to sue for injury to its own interests (see dicta of Palmer J in *Benward v Metal Deck Roofing* [2001] NSWSC 1053)
- A company cannot sue for defamation that has hurt its feelings and in some cases statutes have limited other defamation claims by trading companies (Defamation Act 2005 (NSW))
- Section 109X deals with the service of document on a company
 - Ways of serving a document on a company include:
 - by leaving it at, or posting it to, the company's registered office; or
 - by delivering a copy of the document personally to a director of the company who resides in Australia or in an external Territory
 - A court may:
 - if it appears by credible testimony that there is reason to believe
 - that a plaintiff corporation will be unable to pay the costs of the defendant
 - if successful in his, her or its defence, require sufficient security to be given for those costs and stay all proceedings until the security is given (s 1335(1))

PERPETUAL SUCCESSION

- Perpetual succession is an attribute of a company by virtue of s 119 which provides that on registration a company comes into existence as a body corporate.
- means that the company is a continuing entity in law with its own identity regardless of changes in its membership. The death of some members or sale of their shares does not affect the identity of the company or its rights. Even if a company loses all its members, it can still exist as a company

Re Noel Tedman Holdings [1967] QdR 561

- the only shareholders and directors in a company were husband and wife, who both died in an accident
- The company's articles required its directors to approve any transfer of shares by the legal personal representative of a shareholder to beneficiaries under a will
- There were no directors or members to convene a general meeting of members to elect directors
- The articles allowed legal personal representatives to attend and vote at general meetings in the place of a deceased member
- The executors of the husband's will obtained such an order from the Supreme Court of Queensland calling a meeting of members
- A Court may order the winding up of a company if it has no members s 461(1) and ASIC can apply for such an order s 462(2A)

OWNERSHIP OF PROPERTY

- A registered company has the power to own property because:
 - o s 119 provides that on registration the company comes into existence as a body corporate; and
 - o s 124(1) gives a company the capacity and powers of an individual and the powers of a body corporat
- A company can acquire the full legal beneficial ownership of a particular item of property as absolute owner or any lesser interest
- It can acquire equitable interests and take security
- If property is transferred to a company without any restrictions imposed by the transferor, the company takes the property as absolute beneficial owner, not as a trustee (Bowman v Secular Society Ltd [1917] AC 406 at 440-1; Re Pyke [1974] VR 788)

Company as victim of its controller

- A limited company, being an entity separate from its controller, cannot lawfully consent to its controller appropriating its property otherwise than when permitted by the Corporations Act
- In Macleod v R (2003) 214 CLR 230 it was held that although a person was the controlling mind and the only person interested in a company, he could be convicted of fraudulently applying the company's property contrary to s 173 of the Crimes Act 1900 (NSW)
- The legal fiction that the corporation intends what its organ intends stops short where the organ's intention is that the corporation's property should be applied for purposes outside those which are legally open to the corporation
- For example, any intention of a sole director/shareholder that a company's property should be used for personal purposes cannot be imputed to the company if that use would contravene s 256D as an improper reduction of share capital

COMPANY AS A PERSON

- When a statute uses the word person it can include corporations. The Acts Interpretation Act 1901 (Cth) s 22(1)(a) provides that in any Commonwealth Act, unless a contrary intention appears, "person" shall include a "body politic or corporate as well as an individual" (see: Interpretation Act 1987 (NSW) s 21)
- it does not have all the rights that humans do. At common law a person is entitled to refuse to provide information that could tend to expose that person to a criminal charge or to a civil penalty (this is known as the privilege against self-incrimination). The High Court held by a majority of 4:3 in EPA v Caltex Refining Co (1993) 178 CLR 477 that a corporation is not entitled to the privilege against self-incrimination.

SEPARATE LEGAL ENTITY DOCTRINE

- The separate entity doctrine existed before registered companies and applied to common law corporations. It is a basic doctrine of company law that a company is a legal entity separate from its members
- It is as if there is a screen around the company's members and its directors -this screen is known as the corporate veil. To say a company is a separate legal entity implies that rights and duties attaching to the company are not the rights and duties of its directors or members.

- Parliament may intend to create rights or duties affecting persons behind the corporate screen. The presumption will be that parliament did not intend that the screen should be lifted (Merchandise Transport v British Transport Commission [1962] 2 QB 173, 202 (Devlin LJ))

R v Arnaud (1846) 9 QB 806

- An English chartered corporation applied for the registration of a ship owned by it
- Registration was refused on the ground that the shipping registration legislation excluded foreigners from the privileges of British ship-owners (several of the company's members were foreigners)
- HELD: The court ordered the registering authority to grant the application. The owner of the ship was the corporation and not the members

Salomon v Salomon & Co Ltd [1897] AC 22

- Under the Companies Act 1862 (UK) seven members were required to register a new company
- Aron Salomon (S), with his wife and 5 children registered a limited company under the Companies Act 1862 (UK). S sold his business to the company for £38,782 in exchange for shares and a debt due from the company. S took security over the assets of the company for the debt. S was appointed managing director and controlled the company because his wife and children were committed to voting at company meetings as he directed. The company failed with debts owing to outsiders.
- In the winding up, the assets were insufficient to meet S's secured debt and the claims of the unsecured creditors. The liquidator acting for the unsecured creditors tried to have S's secured debt postponed to the claims of unsecured creditors. The liquidator argued that the company was really S's agent and therefore S had to indemnify it against its business liabilities
- HELD by the House of Lords: that the company had conducted the business in its own right, not as agent or trustee. The 7 persons required for the formation of a company did not have to be independent of each other. S was not liable to indemnify the company and his secured debt had priority over the unsecured creditor's claims

Kahn-Freund described the decision of the House of Lords as "calamitous" (1944) 7 Mod L Rev 54. But it has been said that the "rejection by the House of Lords of the doctrine of agency to impugn the non-liability of the members for the acts of the corporation is the foundation of our modern company law" (MacLaine Watson & Co Ltd v Dept of Trade and Industry [1989] 3 WLR 1033, 1098 (Kerr LJ))

Salomon's case led to the development of what is known in Australia as the "\$2 company"- A proprietary company with only two members, subscribing \$1 each. Now it is possible to have a \$1 company, with one incorporator subscribing for 1 share for \$1 and being the sole director (ss114 (member) and 201A (director)). Traders do not need to put in their own capital, they can operate on credit.

When a proprietary company had to have at least two directors many proprietary companies had an active director (who really conducted the company's business) and an inactive director (appointed to make up the statutory number). The inactive director was usually a spouse, relative or domestic partner of the active director. Yet they could be liable (eg insolvent trading) even after the relationship had broken down

LIMITATION ON THE SEPARATION

- Although a company is a discrete legal entity separate from its directors and members in the sense of having its own legal rights, privileges, duties and liabilities separate from theirs, it is in other respects not separate
- A company cannot act (e.g. enter a contract) unless its directors (or sometimes its members), or agents whom they appoint, act on its behalf.

CONSEQUENCES OF THE SEPARATE LEGAL ENTITY DOCTRINE

LIMITED LIABILITY

- The separate entity doctrine does not automatically give rise to limited liability. It is still possible for a company to be registered as an unlimited company. However, most companies are companies limited by shares in which each shareholder's liability is limited under ss514-529 to the amount (if any) unpaid on shares held by the shareholder
- The definition of a company limited by shares in s 9 is:
 - o a company formed on the principle
 - o of having the liability of its members limited
 - o to the amount (if any) unpaid on the shares respectively held by them
- The status of the company as a separate entity capable of acquiring obligations separate from those of its members allows society to give members the privilege of limited liability on contracts
- Limited liability also reduces members exposure to vicarious liability for torts committed by the company's employees and reduces the amount of insurance that would otherwise be necessary

PROPERTY BELONGS TO THE COMPANY

- A registered company's property belongs to it, not to its members.
- The use of a company can therefore be a double-edged sword if parties do not remember that which party is the owner of the assets in question

Macaura v Northern Assurance Co Ltd [1925] AC 619,

- M sold timber to a company owned by him and his nominees, but he had the timber insured in his name
- The timber was destroyed by fire, but the insurance company refused to pay on the basis that the timber was owned by the company
- The House of Lords upheld the insurance company's refusal to pay

PARTY TO CONTRACTS

- If a company makes a contract, it is the party to the contract, not its directors or members
- If a company commits a breach of a contract made with third persons who knew that they were negotiating with agents acting for a company, it is the company that is liable to the other parties for the breach rather than any agent or director or member acting in good faith to perform the contract (Ferguson v Wilson (1866) LR 2 ChApp 77, 89)
- Companies can contract with their members, even their controlling members.

Lee v Lee's Air Farming Ltd [1961] AC 12

- L formed a company to conduct a business. L was the sole beneficial shareholder and sole governing director for life (though the directorship could be vacated). L contracted with the company to work as chief pilot and was killed in circumstances giving rise to a claim against the company for workers compensation if he was a worker
- NZ Court of Appeal Held that L was not a worker, because as governing director he could not give directions to himself as pilot
- Privy Council Reversed that decision because under Salomon's case it was possible for L to act in two capacities: as the director of the company and as an employee. If he ceased to be director (e.g. by retiring as director) he would still be subject to the employment contract

Lee's case has been applied in Australia

Hamilton v Whitehead (1988) 166 CLR 121 (Mason CJ, Wilson & TooheyJJ)

- Franklyn J thought that it was "wrong and oppressive" to prosecute the respondent for the identical acts and decisions as were relied on as the acts of the company
- There is nothing conceptually wrong in such a course since "it is a logical consequence of the decision in Salomon's case (1897) AC 22 that one person may function in dual capacities":
- A person managing a company can act as an organ of the company so that if it commits a crime, the manager can by the same act be an accomplice with the company
- The company can be convicted as the principal offender and the manager can be convicted as an accessory Hamilton v Whitehead (1988) 166 CLR 121

COMPANY AS DEBTOR OR CREDITOR

- Companies can owe money (be debtors) to their members eg Salomon case
- Companies can also loan money to (be creditors of) their members (Repatriation Commission v Harrison (1997) 78 FCR 442)

LIABILITY IN TORT

- A company can commit a tort as a principal tortfeasor, as where it publishes a libel.
- A company can also commit the tort of deceit (Standard Chartered Bank v Pakistan National Shipping Corporation [2003] 1 AC 959)
- A company can be liable to its injured controlling director where the company is in breach of a non-delegable duty

Nicol v AlmyachtSpars Pty Ltd (1987) 163 CLR 611

- N and B were 2 of the 3 directors of a company and were employed by it
- They agreed to check the fixing of a banner to a flag pole supplied by the company
- They adopted a clearly unsafe system of doing so
- They used an extension ladder fixed to a trestle placed on the tray of a utility
- N fell from the ladder and sustained injuries
- Held: If N had alone devised the system he could have recovered nothing (cf strict liability in Lee v Lee's Air Farming Ltd). The evidence showed that N was not solely responsible for devising the system. He was entitled to recover damages reduced to take account of his own fault having been partly the cause of his injuries

DEPARTURE FROM THE DOCTRINE

- The doctrine requires that rights, privileges, duties and liabilities ascribed by law to the company are not ordinarily ascribed to its directors or members by reason only of their being directors or members. However, there are times where it is deemed necessary to depart from the doctrine

Required by statute

- Sometimes the legislature requires that persons behind the corporate entity be subject to rights or duties that arise out of acts or omissions of the company
- under the Corporations Act, an act of the company, the incurring of a debt in certain circumstances, can lead to the imposition of liability on a director behind the corporate veil

Insolvent trading

- Under s 588G directors are under a duty to stop a company incurring debts when it becomes insolvent
- Under s 95A(2) a company is insolvent when it is unable pay its debts as and when they become due and payable
- If directors fail in that duty and the company is wound up in insolvency, they can be made personally liable for company debts incurred after the company becomes insolvent or debts the incurring of which pushes the company into insolvency

Under General Law

- Directors can be personally liable under s 588G where their action in returning share capital to shareholders leaves the company insolvent
- They can be liable for the amount improperly returned

Fraud

- A court, in exceptional circumstances, may consider that there should be mitigation of the separate entity doctrine as a matter of common law. A court cannot usually just ignore the existence of a company but it can where the company is an element in a series of transactions which constitute a fraud
- In *Re Darby*[1911] 1 KB 95 the court looked behind a Channel Islands company and treated Darby & Gydeas being the true promoters of an English company that failed after buying assets from Darby & Gydeat an inflated price

Company Groups

- Holding company, in relation to a body corporate, means a body corporate of which the first body corporate is a subsidiary (s 9)
- Ultimate holding company, in relation to a body corporate, means a body corporate that:
 - (a) is a holding company of the first mentioned body; and
 - (b) is itself a subsidiary of no body corporate s 9
- Under s 46, a body corporate (in this section called the first body) is a subsidiary of another body corporate if, & only if:
 - (a) the other body:
 - (i) controls the composition of the first body's board; or
 - (ii) is in a position to cast, or control the casting of, more than one half of the maximum number of votes that might be cast at a general meeting of the first body; or
 - (iii) holds more than one half of the issued share capital of the first body (excluding any part of that issued share capital that carries no right to participate beyond a specified amount in a distribution of either profits or capital);
- Under s 46, a body corporate (in this section called the first body) is a subsidiary of another body corporate if, & only if:(b)the first body is a subsidiary of a subsidiary of the other body
- Under s 50, where a body corporate is:(a)a holding company of another body corporate; or (b) a subsidiary of another body corporate; or(c)a subsidiary of a holding company of another body corporate; the first mentioned body and the other body are related to each other
- There may be a vertical relationship between subsidiary body corporate and an immediate or ultimate holding company
- There may be a cross-relationship between subsidiary bodies corporate descended from the same immediate or ultimate holding company
- There may be a diagonal relationship between corporations descended from the same ultimate holding company

Under Resourced Subsidiaries May Be Treated as Agents

- The High Court has held (in the context of ascertaining whether a company has distributable profits) that each company in a corporate group must be treated as a separate entity (*Industrial Equity Ltd v Blackburn* (1977) 137 CLR 567)

- However, a company may be treated as agent of its controller if:
 - o it has not been provided by its controller with resources necessary to perform independently;
 - o and it relies on the resources of its controller as a result
- The most likely scenario is where the controller is a parent company of a wholly-owned subsidiary
Smith, Stone & Knight Ltd v Birmingham Corp [1939] 4 All ER 116
- 6 questions to determine whether the subsidiary was carrying on the business as the parent company's business or as its own, check the following:
 1. Were the profits of the business treated as profits of the parent?
 2. Did the parent appoint the persons carrying on the business?
 3. Was the parent the head and brain of the trading venture?
 4. Did the parent govern the adventure, decide what should be done and determine what capital should be embarked on the venture?
 5. Did the parent make the profits by its skill and direction?
 6. Was the parent in effectual and constant control?
- That test was applied in Australia in Spreag v Paeson Pty Ltd (1990)
 - o a parent company was held liable to pay damages for loss caused by misleading statements made (in contravention of s 52 of the former Trade Practices Act 1974 (Cth)) by its under-resourced subsidiary which had not been provided with its own finance and management.
- Despite Spreag v Paeson Pty Ltd (1990) 94 ALR 679, the fact that companies are part of the same corporate group does not necessarily mean that they are carrying on business in partnership or as agents for one another (Pioneer Concrete Services Ltd v Yelnah Pty Ltd (1986) 5 NSWLR 254)

TYPES OF COMPANY

- o public companies
 - o proprietary companies
- Classification according to liability limit:
If the company is to be able to engage in any kind of business or activity, three types are available:
- o company limited by shares;
 - o company limited by guarantee; and
 - o unlimited company
- o If the company is to be solely a mining company, the applicants have an option to form it as a no liability company

COMPANY LIMITED BY SHARES

- A company limited by shares is funded by each member contributing or promising to contribute, when called upon to do so, a certain amount of money for shares (known as share capital)
- The claim of a member to be repaid the contribution in a winding up is not to be met until all the company's debts have been paid
- The money contributed is not to be repaid before the company winds up except under certain conditions

COMPANY LIMITED BY GUARANTEE

- Guarantee companies cannot increase or reduce the amount of the guarantee either by amendment or by agreement with the members, and this inflexibility makes them unsuitable for any venture whose capital needs are likely to change
- Hennessy v National Agricultural and Industrial Development Assn [1947] IR 159: There is no legal bar to a company limited by guarantee earning profits. However, there is a bar on a company limited by guarantee distributing profits as a dividend to members (s 254SA)

UNLIMITED COMPANY

- Members (and in some circumstances its past members) may be made liable in a winding up for an unlimited company's debts without limit on their liability.
- It is the oldest type of company dating back to the Joint Stock Companies Registration and Regulation Act 1844 (UK) which had no provision for limited liability. That came later in 1855
- An unlimited company can be registered as a proprietary company or as a public company - s 112
- A creditor who cannot recover from an unlimited company must apply to the court for a winding up order before proceeding against its members
- Unlimited companies are not normally used by trading ventures. They are encountered in professions in which practitioners are expected to remain liable without limit and yet be permitted to operate in a corporate form for taxation or other reasons
- The liability of each member is several and a single member could be liable to contribute the full amount needed. That member would have a right in equity to contribution from other members (Albion Insurance Co Ltd v Government Insurance Office of NSW (1969))

NO LIABILITY COMPANY (MINING VENTURES)

- Although a no liability company must have a share capital and members may agree to take shares, their membership does not carry any liability under Pt 5.6 Div2 to pay any calls of share capital either while the company is a going concern or in its winding up -s 254M(2)
- A member can choose whether to pay a call but if they choose not to, the shares will be forfeited – ss254M, 254Q
- To be registered as a no liability company, a company:
 - (a) must have a share capital
 - (b) must have adopted a constitution stating that its sole objects are mining purposes; and
 - (c) must have no contractual right under its constitution to recover calls made on its shares from a share-holder who fails to pay them -s 112(2)

Name to Indicate Liability

- Where the liability of the members is limited, in companies other than a no liability company, the end of the company's name must be the word "Limited" or the abbreviation "Ltd" to give warning to potential creditors -ss148, 149
- The end of the name of a no liability company must be the words "No liability" or the abbreviation "NL" - ss148, 149
- Companies may not be required to have the word limited in certain circumstances s 150

Name to Indicate Proprietary Status

- A proprietary company is required to have the word "Proprietary" or the abbreviation "Pty", as part of its name, inserted immediately before the word "Limited" or the abbreviation "Ltd" or, in the case of an unlimited company, at the end of its name -ss148, 149
- A company limited by shares or an unlimited company may be formed as a proprietary company
- A proprietary company is a private company designed for a relatively small group of persons who do not wish the company to be able to invite the public to subscribe for its share capital or to lend money to it

PROPRIETARY COMPANY

Requirements for Proprietary Companies

- Section 113:
 - o A proprietary company must not have more than 50 non-employee shareholders
 - o It must not engage in any activity that would require disclosure to investors under Chapter 6D, except in the limited circumstances
- Under s 45A(2), a proprietary company is a small proprietary company for a financial year if at least two out of three criteria are satisfied:
 - o the consolidated gross operating revenue for the financial year of the company and the entities it controls (if any) is less than \$25m;
 - o the value of the consolidated gross assets at the end of the financial year of the company and the entities it controls (if any) is less than \$12.5m;
 - o the company and the entities it controls (if any) have fewer than 50 employees at the end of the financial year
- Under s 45A(3), a proprietary company is a large proprietary company for a financial year if at least two out of three criteria are satisfied:
 - o the consolidated gross operating revenue for the financial year of the company and the entities it controls (if any) is \$25m or more;
 - o the value of the consolidated gross assets at the end of the financial year of the company and the entities it controls (if any) is \$12.5m or more;
 - o the company and the entities it controls (if any) have 50 or more employees at the end of the financial year

PUBLIC COMPANY

- If a company is not a proprietary company, it is known as a public company (s 9)
- The Corporations Act enables creation of a company by registration by the one authority, ASIC, whether the company is to operate only within one state or territory or nationally. When it registers a company ASIC issues a certificate that states, among other things, that the company is registered as a company under the Corporations Act.
- An application may be lodged by a person who will be a member of the proposed company. Persons who seek incorporation are commonly called "corporators"
- The proposed company may be formed for any lawful purpose. It is implicit that it could not be formed for an unlawful purpose

- Exceptionally, a trade union cannot be registered under the Corporations Act -s 116
- The application must be in the prescribed form s 117(4) - an ASIC Form 201
- Section 117(2) sets out what the application must contain.
- If the company is to be a public company and is to have a constitution on registration, a copy of the constitution must be lodged with the application s 117(3)
- An applicant must have the consents and agreements referred to in subsection (2) when the application is lodged s 117(5)
- After the company is registered, the applicant must give the consents and agreements to the company. The company must keep the consents and agreements s 117(5)

Setting Up A Company

- Under s 117(2) the application to ASIC for registration must contain details of each person who consents in writing to become a member
- Members may be individuals or bodies corporate, either private or government -s 231 and the definition of member in s 9
- Section 22(1)(a) of the Acts Interpretation Act 1901 (Cth) defines "person" to include bodies politic and corporate
 - o A company can be a member of another company
 - o The minimum membership for any type of company is one -s 114

Directors

- Under s 117(2) the application to ASIC for registration must contain details of each person who consents in writing to become a director
- Only an individual who is at least 18 may be appointed as a director of a company -s 201B
- On registration of the company the consenting persons will become directors without further appointment -s 120(1)
- A proprietary company must have at least 1 director. That director must ordinarily reside in Australia -s 201A(1)
- A public company must have at least 3 directors (not counting alternate directors). At least 2 directors must ordinarily reside in Australia - s 201A(2)

Secretaries

- Under s 117(2) the application to ASIC for registration must contain details of each person who consents in writing to become a company secretary
- Only an individual who is at least 18 may be appointed as a director of a company -s 204B
- On registration of the company the consenting persons will become directors without further appointment -s 120(1)
- A proprietary company is not required to have a secretary but, if it does have 1 or more secretaries, at least 1 of them must ordinarily reside in Australia-s 204A(1)
- A public company must have at least 1 secretary. At least 1 of them must ordinarily reside in Australia -s 204A(2)

Registered office

- Each company must have a registered office in Australia -s 142
- On registration the address specified in the application for registration becomes the address of the registered office -s 121
- A public company must have its registered office open to the public during specified hours -s 145

Use of company's name

- Because a company has no physical manifestation it is important that its identity be well evidenced by the use of its name. A company is required to exhibit its name outside every place where its business is carried on that is open to the public or is its registered office -s 144.
- It must set out its name and its CAN on:
 - o all "public documents" (defined in s 88A);
 - o every "negotiable instrument" (defined in s 9 to include among other things bills of exchange, promissory notes cheques); and
 - o the company's common seal (if any) -ss123 & 153
- If a company carries on a business under a name that is not the company's name, it must register the business name under the Business Names Registration Act 2011(Cth)

Promoters

- A person who is involved, as a principal or an assistant, in getting up and starting a business undertaking can be a promoter. The term promoter is a term not of law, but of business, usefully summing up in a single word a number of business operations familiar to the commercial world by which a company is generally brought into existence (Whaley Bridge Calico Printing Co v Green & Smith(1879) 5 QBD 109)
- Promoters who seek the co-operation of other persons in the flotation of a company, particularly fund-raising, are required to display the "utmost candour and honesty": (Central Railway of Venezuela v Kisch(1867) LR 2 HL 99, 113)
- In the past it has been possible for unscrupulous promoters to abuse the law about company formation by forming a company with a co-operative board of directors to which they sell assets at an inflated price to be met from the proceeds of offers of the company's securities to the investing public
- If promoters sell property to the company without full disclosure to the company, the sale is liable to be set aside with a requirement that the purchase money be refunded (Tracy v Mandalay Pty Ltd(1953) 88 CLR 215)
- This is less of an issue today as there are stringent requirements in Chapter 6D of the Corporations Act about disclosure in fundraising documents
- These include reports of independent valuers, and the imposition of civil and criminal liability for false statements or material omissions in fundraising disclosure documents