

Table of Contents

1. Introduction	3
What is a company?.....	3
Administration of Australian companies	8
Why form a company?.....	9
How do you form a company?	9
2. Corporate Personality and Limited Liability	10
The doctrine of corporate personality.....	10
Separate corporate personality and limited liability	10
Piercing the veil of incorporation.....	13
3. Corporate Constitution	22
What is a corporate constitution?.....	22
Alteration of the corporate constitution.....	24
Effect of the corporate constitution.....	27
Executive directors' service contracts	28
4. Corporate Organs	30
Division of power between the corporate organs	30
General meeting	33
Informal decisions by shareholders	36
Shareholder access to corporate information	38
Functioning of the board of directors	38
Directors' access to information	39
5. Binding the Corporation	40
Capacity of the corporation	40
Authority of organs and agents.....	40
Breach of duty.....	46
6. Directors' Duties	47
To whom is the duty owed?.....	47
Duty to act in good faith for the benefit of the company and for a proper purpose	48
Directors' obligations to avoid conflict between duty and interest	57

Duty of care, diligence and skill.....	60
Insolvent trading	62
7. Shareholders' Rights and Remedies	65
Equitable limitations on the voting power of majorities	65
Shareholder actions	67
Statutory protection for minorities.....	67
Protection of class rights.....	70
8. Corporations Act Provisions	71
9. Problem Question Revision Answers.....	150

1 CORPORATE PERSONALITY AND LIMITED LIABILITY

1.1 The doctrine of corporate personality

- **Separate legal entity doctrine:** The company is a legal person separate from its participants. Its obligations and property are its own and not those of its participants; and its existence continues unchanged even if the identity of the participants changes.
- **s 124(1):** A company has **two types of powers:** powers of an individual; and powers of a body corporate (e.g. issuing shares and debentures) (s 9: 'debenture' – 'a chose in action that includes an undertaking by the body to repay as a debt money deposited with or lent to the body. The chose in action may (but need not) include a security interest over property of the body to secure repayment of the money.')
- **s 124(2):** Co legal capacity is **not affected** by the fact that the co?
- **s 124(3):** Does not authorise a company to do anything prohibited or denied by a State/Territory law.
- **s 125:** Effect of constitution upon company's powers
 - **s 125(1):** Exercise of a power by the company is not invalid **merely because** it is contrary to an express restriction, or prohibition, in the company's constitution.
 - **s 125(2):** An act of a company is not invalid **merely because** it is contrary to or beyond any objects in the company's constitution.
 - **SUMMARY – The company:** has its own rights and obligations; has its own assets and liabilities; can sue and be sued or prosecuted; can contract with its controllers; has perpetual succession (infinite life); is a separate taxpayer; participants (**may**) have limited liability.
- **Limited Liability:** s 516 – 'A member of a **company limited by shares** need not contribute more than the amount (if any) unpaid on the shares where the company is wound up:
 - e.g. 100 x fully paid up \$1 shares = \$0.00 liability
 - but, 100 x 50% paid up \$1 shares = \$50.00 liability

1.2 Concepts of separate corporate personality and limited liability

- Lord Chancellor Thurlow: 'Did you ever expect a corporation to have a conscience, when it has no soul to be damned, and no body to be kicked?'
- General interpretation statutes of the Cth and the States: a reference in legislation to a '**person**' **includes a reference to a body corporate**, subject only to a contrary intention appearing in a particular statute: *Acts Interpretation Act 1901* (Cth) s 22; *Interpretation Act 1897* (NSW) s 21(c).
- **Separate personality doctrine:** **Salomon's Case.**
Salomon's Case: **Established the idea that the shareholders and the management are altogether different from the legal, fictitious corporate person.**
- See s 124 *Corporations Act*: A company is a legal person who can do everything that a natural person can do, plus more (e.g. issuing shares and debentures).

→ **And:** established the idea that the benefits of incorporation extend to companies effectively under the control of a single person.

Salomon v Salomon & Co Ltd [1897] AC 22: Aron Salomon decided to incorporate his shoe business as 'Aron Salomon and Company Limited'. Under the *Companies Act 1862* (UK), there had to be 7 subscribers to the memorandum of association: Salomon, his wife, daughter and four sons had one share each. The company entered into an agreement to purchase Salomon's business, issuing 20,000 shares to Salomon. There was a debenture of £10,000 as an outstanding debt payable to Salomon, secured by way of a floating charge. Salomon went from sole trader → director of a company, major shareholder, secured creditor and its main employee.

→ After a depression and several strikes, Salomon lost all of his government contracts. Salomon took a loan from Broderip – to secure the loan, Salomon cancelled and reissued his debenture to Broderip, but retained the residual beneficial interest in the debentures after Broderip's debt was discharged. Broderip enforces his security and the company's liquidation ensued. Broderip was paid; but there was not enough to pay the unsecured creditors. The question: Was Salomon able to claim his reversionary interest to claim the £1,055 over his unsecured creditors?

At first instance: Vaughan Williams J held that Salomon had no such preference over the unsecured creditors. He was unsure, but felt that Salomon ought to indemnify the company for its indebtedness. He agreed with the liquidator in that he felt that the issuing of the debenture to B should be invalidated on the basis of **fraud**.

→ Thus, the £1,055 should be applied to **unsecured creditors**. As obiter, Vaughan Williams J held that he could not prove it, but felt that there was fraud.

Court of Appeal: Salomon's appeal was dismissed on different grounds – CA held that Salomon was not really a principal who should indemnify his agent.

→ Lindley LJ: thought that the company was 'a trustee for Salomon' and that the other members of the company have 'practically no interest' and were used 'to screen himself from liability' (at 338). He felt that Salomon was liable to indemnify the company and that the creditors could only reach him through the company.

- Regarding this use of the Act for 'one man' companies, Lindley LJ held: '...until the law is changed, such attempts as these ought to be defeated whenever they are brought to light. They do infinite mischief...by making it an instrument for cheating honest creditors.'

→ Lopes LJ (at 340-1): 'It never was intended that the company to be constituted should consist of one substantial person and six mere dummies, the nominees of that person, without any real interest in the company.'

- 'To legalise such a transaction would be a scandal.'
 - **Underlying policy:** notions of fairness. Salomon was responsible for the failing of the company. It was unfair for him to prevail over unsecured creditors. The lower courts all frowned upon the one person company.

House of Lords: Salomon wins! HoL held that Salomon is entitled to the reversionary interest in the debentures.

- Lord MacNaghten at [52]: ‘The unsecured creditors of A Salomon and Company, Limited, may be entitled to sympathy, but they have only themselves to blame for their misfortunes.’
 - **Held that it was legitimate to move from a sole trader business to a company limited by shares to adopt the benefits of shielding oneself from bankruptcy by trading as a corporation.**
- Lord Halsbury LC: Adopted a similarly strict approach – the sole guide must be the 1862 Act. The Act does not qualify the interest in the shares – all that was required was seven individuals to get registration. Motives of the incorporator are unimportant. The argument that Salomon committed fraud was, to Halsbury, both inconsistent and unpersuasive (in particular writing against Lindley LJ).
 - At [33]: ‘My Lords, the learned judges appear to me not to have been absolutely certain in their minds whether to treat the company as a real thing or not. If it was a real thing; if it had a legal existence, and if consequently the law attributed to it certain rights and liabilities in its constitution as a company, it appears to me to follow as a consequence that it is impossible to deny the validity of the transactions into which it has entered.’

Lee v Lee's Air Farming Ltd [1961] AC 12 (PC): Lee was the **majority shareholder** and **director** and **main employee** of Lee's Air Farming Ltd. Lee dies in a plane crash – his wife wishes to claim insurance as the widow of a ‘worker’ but the insurance company (and the NZ Court of Appeal) deny her claim. Their reasoning was that Lee, as the governing director, in whom the full government and control of the company was vested, could not also be its servant as a worker.

- Lord Morris (for the PC) at [25]: ‘Their Lordships find it impossible to resist the conclusion that the active aerial operations were performed **because the deceased was in some contractual relationship with the company**. That relationship came about because the deceased **as one legal person was willing to work for and to make a contract with the company which was another legal entity**.’
- ‘It is **well established** that the mere fact that someone is a **director** of a company is **no impediment to his entering into a contract to serve the company**.’
 - At [26]: ‘...it is a **logical consequence of the decision in *Salomon's case* that one person may function in dual capacities**.’
 - ‘The fact that so long as the deceased continued to be governing director, with amplitude of powers, it would be for him to act as the agent of the company to give the orders does **not alter the fact that the company and the deceased were two separate and distinct legal powers**.’
- **On the basis of *Salomon's case*** the Court held that:
 - A company is a **separate legal entity**
 - A company can **create contracts**, including contracts for service (contractors) and contracts of service (employee)
 - **As a director**, Mr Lee could **make an offer of employment** on behalf of the company

- **As a person**, Mr Lee could **accept that offer** of employment
- Mr Lee was a **director of the company and also an employee** – workers' compensation was payable for death at work

Macaura v Northern Assurance Co Ltd [1925] AC 619: An individual owned trees. He transferred the forest to the company, but neglected to transfer the insurance policy that went along with it. The trees burned, but were uninsured – he tried to make a claim but was unsuccessful because of the lack of insurance policy. Thus, the insurance company was well within its rights to deny the policy.

→ Nowadays, the outcome of a case like this is determined by amendments to insurance legislation – doesn't really affect corporations law though.