

Lecture 2: Incorporations and its Consequences

Separate legal personality

- Based on *Salomon v Salomon & Co Ltd* [1897]
 - Salomon was a sole trader
 - He sold the business to a limited company he formed
 - In return, the company issues him 20,001 fully paid shares for part of the purchase price and gave him a secured debenture (acknowledge of debt) for the balance
 - His wife and children took up a single share each (no public shares)
 - What happened?
 - During the depression the company essentially collapsed/was put into liquidation
 - 8000 pounds were left after everything had been sold
 - Salomon said it was his as he had a mortgage over all the company's assets
 - The liquidator said the money should go first to the unsecured creditors
 - What was the verdict?
 - Court of appeal said Salomon is wrong
 - The House of Lords (highest court in England) said Salomon is right
 - The company is a separate legal person, however, he would have been wrong if:
 - The company could show there was an agency situation
 - If they could show there was a trust
 - If the company could show there was fraud
 - This case tells us:
 - This shows the strength of corporate legal identity
 - The things the court would have regarded as exceptions
 - If you want to sell to a company, this is how to do it
 - Consequences of a separate legal entity include:
 - Personal and company debts are distinct
 - Personal and company assets are distinct
 - *Macaura v Northern Assurance Co Ltd* [1925]
 - Mr. Macaura sold his business to a company
 - He did not transfer the insurance policy to the company
 - After a fire, the insurance company would not pay Mr. Macaura as the timber was a company asset
 - The House of Lords upheld the argument of the insurance company
 - The company may contract with its members (and directors)
 - *Lee v Lee's Air Framing Ltd* [1961]
 - Mrs Lee wanted to claim employee insurance
 - Lee was a shareholder and director who signed a contract to work as chief pilot
 - The insurance company claimed he was not an employee
 - Mrs Lee's claim was upheld as one person may function in dual capacities

Ignoring (lifting or piercing) the Corporate Veil

- The corporate veil is a theoretical screen which descends when a company is incorporated
- In some cases, courts may want to look behind this to determine why the company was formed or who is actually controlling it
- Exceptions to the principle of separate legal personality:
 - Under Case Law (or Common Law)

Mask or sham	<ul style="list-style-type: none">• Used to hide the real purpose of the controller• Improper or dishonest attempt to avoid debts• The court will not take the company at face value
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Avoidance of legal obligation	<ul style="list-style-type: none"> Deliberately using companies to avoid contractual obligations Gilford Motor Co Ltd v Horne [1933] <ul style="list-style-type: none"> Horne created a new company to engage in similar services to his previous company, Gilford Gilford sought an injunction The court said the company was a 'cloak' used to commit breaches of his contractual obligations The court made an injunction for Horne and the company (as it was almost wholly owned)
Fraud	<ul style="list-style-type: none"> If the company is used as a vehicle to conduct fraud Re Darby; Ex parte Brougham [1911] <ul style="list-style-type: none"> Darby wanted to retain profits on sale through a dummy company (CLIC) The court ordered Darby to surrender the profits
Assistance in breach of fiduciary duties	<ul style="list-style-type: none"> In the case where a company has knowingly assisted in a director's breach of fiduciary duty

- Essentially it's based on separate legal personality
- An exception is if a business is carrying on business as an agent
 - Smith Stone & Knight Ltd v Birmingham Corp [1939]
 - A first instance decision case
 - The subsidiary company was carrying on business as agent for its parent company (sharing profits etc.)
 - The two companies could not be treated as separate
 - However, this is not always followed

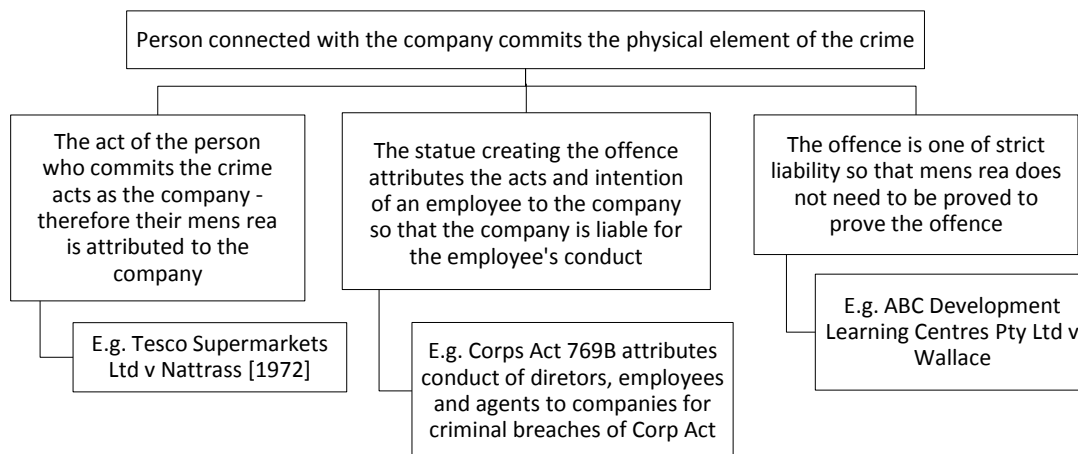
○ Under Statute

Section 588G and 588M	Personal liability of directors for insolvent trading	<ul style="list-style-type: none"> Imposes personal liability on directors who allow a company to incur debts while insolvent
Section 260A	Financial assistance	<ul style="list-style-type: none"> A company is prohibited from giving assistance for the acquisition of its own shares The company officers become liable
Section 267	Company officer charges	<ul style="list-style-type: none"> Designed to prevent an insolvent company granting a charge in favor of an officer to avoid prejudice to the company's creditors
Section 197	Director's liability as trustee	<ul style="list-style-type: none"> Imposes personal liability on the directors for certain debts incurred by the corporate trustee which manages the trust If the trustee enters into a transaction in breach of the terms of trust, the trustee will lose their right of indemnity

Corporate Criminal Liability

- Proceedings are commenced by ASIC or Commonwealth Director of Public Prosecutions
- General principle is to prove:
 - Beyond reasonable doubt
 - Actus reus (guilty act)
 - Mens rea (guilty mind)
 - You intended it or were reckless about it
 - ABC Development Learning Centres Pty Ltd v Wallace [2006]
- Or there are some crimes of absolute liability (you only need to prove the act)

Summary of liability in crime



Corporate Liability in Contract

- In order to decide if the company is bound:

Corporations Act	<ul style="list-style-type: none"> Section 129: The other party (outsider) may assume that: <ul style="list-style-type: none"> The constitution has been complied with Appointments have been properly made Officers have their customary authority The company seal has been correctly used Duties have been performed for a proper purpose Section 128(A): The assumptions in 119 may not be used if the outside has: <ul style="list-style-type: none"> Actual knowledge to the contrary (known) Imputed knowledge to the contrary (suspected)
Agency law; determining an agent	<ul style="list-style-type: none"> Actual authority <ul style="list-style-type: none"> Between the principle and agent Expressed or implied E.g. replaceable rules authorized the board of directors to exercise the power of the company Apparent/ostensible <ul style="list-style-type: none"> The principle holds out a person as agent to the other party Arises by law in certain circumstances where consent from the principle is absent The person has the appearance of authority Freeman & Lockyer v Buckhurst Park Properties Ltd [1964] says four things must be shown; <ul style="list-style-type: none"> The company represented the person had authority to enter into a contract of the kind The representation was made by persons with actual authority The other party to the contract relied on the representation The company had authority to enter into the contract and to delegate authority to enter into it under its constitution By ratification/retrospective <ul style="list-style-type: none"> The act of a person purporting to be an agent is adopted by the principle No authority at the time of the contract, but may have authority granted in retrospect Breach of warranty of authority is when the company does not accept
The Indoor Management Rule	<ul style="list-style-type: none"> Potentially an earlier and less developed version of the agency rule Says that an outsider acting in good faith can assume internal procedures have been followed

	<ul style="list-style-type: none">○ Even if the company has not followed set procedures○ Even if there is a forged document○ Unless the outsider knows otherwise● Royal British Bank v Turquand [1856]<ul style="list-style-type: none">○ Money was borrowed using the common seal, but not approved by shareholders○ It had to be repaid as the bank was permitted to assume it was legitimate
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Lecture 3: Internal Operations of the Company

Corporate Structure

The History of Corporate Structure

- A number of companies were incorporated before 1998, therefore the old structure is important
- Before July 1998: companies were incorporated with two documents:
 - Memorandum of Association – the structure of the company
 - The Articles of Association – which regulated the company, i.e. the replaceable rules/constitution
 - Found in Table A of the Act
- From 1 July 1998: Replaceable Rules in the Act and/or Corporate Constitution

Section 198A

- Section 198A 'Powers of directors' replaceable rule is important
 - It says the business of a company is to be managed by or under the direction of the directors
 - The directors may exercise all the powers of the company
 - Can the members override the directors?
 - Automatic Self-Cleansing Filter Syndicate Co Ltd v Cuninghame [1906]
 - Once the company is formed with such a provision in its constitution the member are not permitted to tell the directors how to manage the company
 - Therefore the only way for members to direct the board of directors is to alter the constitution (or get rid of the directors)
 - To change a constitution you need a special resolution (75% of members or more), not ordinary (>50%)

Section 140(1)

- Section 140(1) Statutory Contracts, says the replaceable rules operate as a contract specially between the various people shown below:
 - Section 140(1)A: Between company(one side) and each member (on the other)
 - Hickman v Kent or Romney Marsh Sheepbreeders' Association [1915]
 - Hickman was expelled from the company
 - Legal proceedings were stopped as the constitution said the matter needed to be settled by dispute resolution, not litigation
 - Elev v Positive Government Security Life Assurance Co [1875]
 - E the company's solicitor appointed without resolution
 - The company stopped employing him and he maintained his position was protected in the constitution
 - The decision was the constitution could only be enforced by a member in so far as it affected their membership status
 - If a member/director/ secretary wants to sue using Section 140, it has got to be about the constitution/replaceable rules
 - You can sue to enforce the constitution
 - Section 140(1)B: Between company its directors and secretaries
 - Nothing in company law that says you need to be a member to be a director/secretary
 - Section 140(1)C: Between the members themselves

Amending the Corporate Constitution

- Process involves a special resolution of members' meeting (Section 136(2))
 - Notice provided 21 days in advance
 - Exact change of words must be provided in notice of the meeting
 - 75% of those voting, not an absolute majority
 - Then a public company must file the amended constitution with ASIC

- Then a sole member company need only sign a record of amendment
- The primary restrictions on the alteration of the constitution are in the Corporations Act:
 - Section 140(2) the statutory restriction is the limitation on retrospectively
 - You can't enact anything to increase the liability of members over what they've already got
 - Members will only be bound if they agree in writing
 - Section 232-234 protection of minority members against oppression/prejudice
- There is also a restriction in case law
 - This is based on the nature of a share
 - Shares are a mixture of contract and property
 - Property is right to dividends and your right to your proportionate share of net profit when the company is wound up
 - If you change the constitution, you are meddling with people's contractual and property rights
 - Peters' American Delicacy Ltd v Heath [1939]
 - Refers to 'proper purpose'
 - Where property interests are involved, decisions need to be made based on the interests of the company as a whole
 - Gambotto v WCP Ltd [1995]
 - When property rights are involved, there is:
 - The proper purpose test
 - That the operation is fair

Becoming a member

- Relating to Section 231
- A person is a member if they are:
 - Section 231(A) are a member of the company on its registration
 - Section 231(B) agree to become a member of the company after its registration and their name is entered on the register of members
 - Section 231(C) become a member of the company under s167 (arising from converting from limited by guarantee to limited by shares)
- Methods of becoming a member in (a) and (b) include:
 - Agreement in the application for registration of the company
 - Acceptance by the company of application for new shares
 - Transfer from another member
 - Transmission (death or bankruptcy)
 - Exercise of share options
 - Conversion of convertible debentures

Register of members

- According to Section 169:
 - Says the company needs to include a register
 - Details include name, address, number of shares, date of acquisition
 - Inclusion of a name onto the Register is legally significant because once a company's initial capital is established, any subsequent shareholders only derive from their legal status as members from inclusion of the register
 - Maddocks v DJE Constructions Pty Ltd [1982]
- According to Section 175:
 - You can apply to the court to have the Register rectified
 - E.g. if the directors refuse to admit the new member
 - If the court orders the Register to be corrected, it may order the company to compensate the party for loss/damage

Right to Inspect the Register

- According to Section 173:
 - All members have a right to inspect the register and can't be charged for doing so
 - If you are not a member, you may apply to the company for permission, however, you can then be charged
- According to Section 177:
 - Section 177(1)(a), there is a prohibition that says a person must not use information about a person obtained from a register to contact or send material to that person
 - Section 177(1A), the exception is if its relevant to the holding of the interests recorded in the register or the exercise of the rights attaching to them, or approved by the company
 - IMF (Australia) v Sons of Gwalia Ltd [2005]
 - A class action funder could not contact members regarding information about a class action relating to their purchase of shares as it was not relevant to the holding of the interests recorded in the register

Meetings of Members

- According to Section 249(L), noticed must include
 - Content of notice: place, date, time, general nature of business
 - Associated material about voting: copies of motions which require a special resolution, details of proxy rights
- Types of resolutions
 - Ordinary resolution: a simple majority, more than 50% of those voting (50% exactly means status quo maintained)
 - Special resolution: 75% or more of votes cast, but must have given notice of motion
 - Signed resolutions: without holding a formal meeting but by circulating the proposed resolutions, 100% of members must agree
 - This is a replaceable rules for public companies but not for proprietary companies
- According to Section 251(A), minutes of the meetings must also be maintained

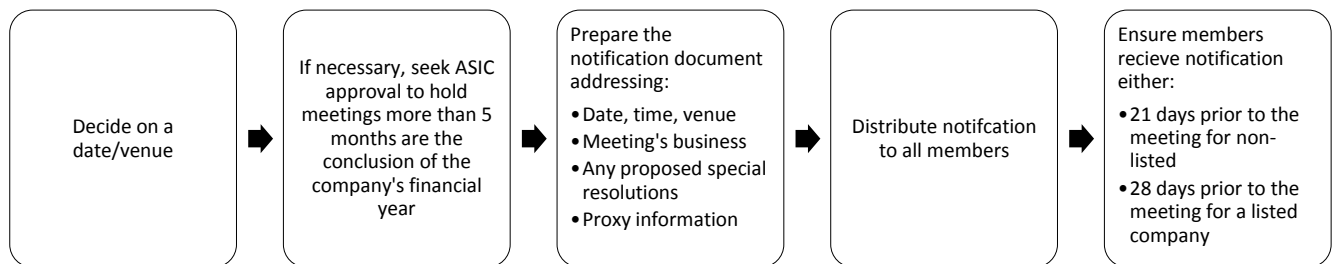
Voting at Meetings of Members

- Show of hands unless a poll is demanded
- There can be a call for a poll (which is a replaceable rule)
 - Members can call for a poll
 - The possibility is any five members, or people who would have 5% of voting on a poll, or the chair
- Voting on a poll:
 - Depends on the number of shares held and voting rights attached to them
 - Ordinary shares usually one vote per share
 - Other classes may have no votes, votes in special circumstances, or any number of votes attached to them
 - N.B. The ASIC will not list unvoting shares
 - According to Section 249(X) and (Y), a proxy can be appointed to attend and vote on behalf of a member
 - They have the same rights as a member
 - However, if a company has a constitution it may provide that a proxy is not entitled to vote on a show of hands
 - This is a replaceable rule for proprietary companies but compulsory for public
 - Whitlam v ASIC [2005]
 - If you appoint a proxy, you should be careful whom you choose
 - Whitlam failed to sign a number of proxy votes against the resolution to increase director's remuneration

- The court decided he was not in breach of director duties (but duties to individuals) and therefore could not be banned as company director

Annual General Meetings (of Members) - AGM

- At one time, all companies had to have an AGM but now only public companies have to have AGM (Section 250N(2))
- According to Section 250(R), the meeting is held to consider:
 - Annual financial reports, director reports and auditor's report
 - Election of directors
 - Appointment of auditor
 - Auditor's remuneration



Extraordinary General meetings (of Members) – EGM, any meeting other than an AGM

- Section 249C: A director may call a meeting
- Section 249D: Meetings must be called by directors on request of members (as specified)
 - Must take place within two months
 - The company will pay for the meeting
- Section 249F: Meetings may be called by members (as specified)
 - Members may call it if the above fails
 - And only if at least 5% of the votes that may be cast join in the call
 - The 5% will need to pay in this case
- Section 249Q: Any meeting must be for a proper purpose
 - Overriding rule
 - The directors decide proper purpose (which is the weakness is 249(D))

Procedural irregularities at a meeting

- Section 1322(1): Example of irregularities
 - E.g. not a quorum, the meeting or notice was invalid, there was no notice
- Section 1322(4): Power of court to make a range of remedial orders
- Section 1322(6): Preconditions to making remedial orders
- Section 1322(2): No invalidation unless substantial injustice
 - If you apply under this process, it's likely to find the court makes remedial orders