

| <b>Lecture 5 – Internal Governance and Corporate liability</b>   |   |
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| <i>Understand source of internal governance rules of co</i>  | <p><b>Corporate constitution</b><br/>Prior to 1998 reforms 2 distinct constitutional documents</p> <ol style="list-style-type: none"> <li>1. the memorandum of association (memo) <ol style="list-style-type: none"> <li>a. document - contained basic matters such as co's capital structure and nature of members liability</li> </ol> </li> <li>2. articles of association <ol style="list-style-type: none"> <li>a. "house keeping matters" e.g. Appointment and removal of directors, Powers of directors, inspection of books, directors' meetings</li> </ol> </li> </ol>   |
| <i>Understand relationship between the company's constitution and replaceable rule</i><br><br><b>S141 – replaceable rules</b>  | <p><b>After (1 July 1998) have choices determining their rules of internal management.</b><br/>Such co's may elect to:</p> <ul style="list-style-type: none"> <li>• adopt replaceable rules contained in Corporations Act (<b>s 141</b>)</li> <li>• draft their own constitution in a single document</li> <li>• have a combination of both (<b>s 134</b>).</li> </ul> <p>Note: Exception applies to no liability companies (<b>s 112 (2)</b>).</p> <p><b>s 141</b>, table conveniently lists 39 different replaceable rules covering</p>   |
| <i>Explain legal nature of company's constitution and replaceable rules</i><br><br><b>S140 – constitution has a legally binding effect</b>   | <p><b>s140(1):</b> a co's constitution (if any) and any replaceable rules that apply to the company have effect as a contract:</p> <ul style="list-style-type: none"> <li>• between the co and each member (Hickman's case) and</li> <li>• between the co and each director and co-secretary; and</li> <li>• between a member and each other member.</li> <li>• Sec 140 creates a statutory contract - not binding on an outsider to the co (Forbes v NSW Trotting Club).</li> </ul>  |
| <i>Explain manner in which constitution/rules can be altered</i><br><br><b>S136 – special resolution</b><br><b>S140 – written agreement</b><br><b>S246 – procedures for class rights</b><br><b>S232 - oppression</b> | <p><b>Altering the constitution</b></p> <ul style="list-style-type: none"> <li>• Require special resolution: <b>s 136</b></li> <li>• General freedom to alter contents constitution is limited by both statutory (corporations act) and general law protection (judge made law) <ul style="list-style-type: none"> <li>○ <b>S 140(2):</b> members written agreement needed if required to take up extra shares or increase their liability to contribute capital;</li> <li>○ <b>S 246B</b> set out procedure to vary or cancel class rights attaching to shares</li> <li>○ <b>S 232-234</b> protects minority members against oppressive, or unfairly prejudicial or unfairly discriminatory conduct and offers remedies</li> </ul> </li> <li>• Alteration of constitution to compulsory acquire shares of minority shareholders will only be valid if done: <ul style="list-style-type: none"> <li>○ for a proper purpose; and</li> <li>○ is fair in the circumstances: <b>HC in Gambotto v WCP Ltd (1995)</b></li> </ul> </li> </ul>  |
| <i>Explain contractual capacity of companies (full or limited?)</i>  | <p><b>S 198A:</b> gives directors right and power to manage co<br/>Co can be liable for civil and criminal wrongs in 1 of 2 ways</p> <ol style="list-style-type: none"> <li>(1) Primary liability (co personally liable when it has committed wrong itself via its controllers and directing mind - directors)</li> <li>(2) Secondary liability (co strictly liable for actions of its employee in some circumstance)</li> </ol> <p><b>Co's contractual Capacity/liability</b></p> <ul style="list-style-type: none"> <li>• <b>S 124</b> confers powers on co (can do most things that an individual can – includes capacity or power to contract)</li> <li>• Co acts through its: <ul style="list-style-type: none"> <li>○ <u>corporate organs</u>: general meeting of members and board of directors and;</li> <li>○ via <u>human agents that they appoint</u></li> </ul> </li> <li>• <b>s124</b>, together with <b>s125</b>, effectively gives the co full contractual capacity</li> <li>• Under modern law, co has unlimited contractual capacity</li> </ul> <p><b>Contracting directly</b></p> <ul style="list-style-type: none"> <li>• Via use of the co's common seal</li> <li>• <b>s 127(2)</b> requires seal (if in use) to be witnessed by: <ol style="list-style-type: none"> <li>a) 2 directors; or</li> <li>b) a directors and a co secretary; or</li> </ol> </li> </ul> |

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|  | <p>c) if it's a pty co with sole directors/secretary – that director.</p> <ul style="list-style-type: none"> <li>Under s 127(1), co can execute a doc in the same way as above (whether or not it has a seal).</li> </ul>   |
| <p><i>Explain authority of a company's officer and agent to contract</i></p>   | <p><b>Contracting thro' agents</b></p> <ul style="list-style-type: none"> <li>A co is legally bound by a contract made on its behalf by an agent with authority</li> <li>An agent can have: <ul style="list-style-type: none"> <li><u>actual authority</u>: [express or implied]; or</li> <li><u>apparent authority</u> – appearance of authority i.e. agent does not have authority but the appearance may be good enough.</li> </ul> </li> </ul> <p><b>Freeman and Lockyer v Buckhurst Park Properties:</b></p> <ul style="list-style-type: none"> <li>Must be fulfilled to entitle a contractor to enforce against a company a contract entered into on behalf of the company by an agent who had no actual authority to do so.</li> <li>It must be shown: <ul style="list-style-type: none"> <li>that a representation that the agent had authority to enter on behalf of the company into a contract of the kind sought to be enforced was made to the contractor; <b>[a “holding out”/representation made]</b></li> <li><b>[by someone with actual authority]</b></li> <li><b>[on which the other person relied, induced by that representation to contract]</b></li> </ul> </li> </ul> <p>In <b>Northside case</b>, High Court considered authority of an individual director and held: Directors can <u>act only collectively as a board</u></p> <p><b>Panorama Developments</b> - Co secretary does not have implied authority to manage the co but, Implied authority to <u>manage the administrative affairs of the co.</u></p>  |
| <p><i>Explain manner in which companies can be liable in contract</i></p> <p><b>Turquand: Indoor management Rule</b><br/>CA = s128-129</p> <p><b>Exceptions of IMR = Northside</b></p> | <ul style="list-style-type: none"> <li><b>At common law:</b> 'indoor management rule'; 'rule in Turquand's case'</li> </ul> <p><b>Royal British Bank v Turquand</b> “<i>persons dealing with a company in good faith may assume that acts within its constitution and powers have been properly and duly performed and are not bound to enquire whether acts of internal management have been regular.</i>”</p> <p>Held that parties dealing with co's (in good faith) have the right to presume that the internal processes of the co have been properly carried out.</p> <p>Under the rule, outsider can assume that</p> <ul style="list-style-type: none"> <li>There are no procedural defects in the appointment of directors;</li> <li>A board meeting has been properly called and held;</li> <li>Any board or general meeting approval required (under the Act; constitution; rules) has been obtained.</li> </ul> <p><u>Exceptions to Rule</u></p> <p>Outsider is prevented from relying on indoor management rule (at common law) if:</p> <ol style="list-style-type: none"> <li>the 'actual knowledge' exception applies; or <ul style="list-style-type: none"> <li>as an outsider if you know that the company has not followed the rules</li> </ul> </li> <li>the 'put on inquiry' exception applies. <ul style="list-style-type: none"> <li>Based on an objective test. If a reasonable person would have been suspicious and made inquiries</li> </ul> </li> </ol> <p><b>Northside case:</b> 'A person dealing with a company is put upon inquiry what that company enters into a transaction which appears to be unrelated to the purposes of its business and from which it appears to gain no benefit.'</p> <p><b>Under the Corporations Act: ss128-129</b> reinforces common law - allows outsiders to make a series of assumptions when contracting with a company</p> <p><b>Outsider entitled to assume (s 129)</b></p> <ol style="list-style-type: none"> <li>Acts of internal management complied with [similar to the 'indoor management rule'];</li> <li>About authority of certain officers;</li> <li>Officer/agent held out as apparent authority;</li> </ol> |

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|  | <ul style="list-style-type: none"><li>4) Documents are validly executed if signed/witnessed by officers &gt; entitled to assume it is proper</li><li>5) Documents are genuine if claimed by co's officers/agents [even if it later turns out to be a forgery]</li></ul> |
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**Limitations to statutory assumptions: s 128**

Outsider cannot rely on these assumptions (in s 129) if:

- (1) They have actual knowledge to the contrary; or (if you know that the actual document is incorrect)
- (2) They suspect that the assumption is incorrect (like put on inquiry)