

# CONTENTS

<b>PROBLEM QUESTION APPROACH .....</b>	<b>6</b>
<b>DEFINITIONS: CORPORATE GROUPS.....</b>	<b>8</b>
Subsidiaries .....	8
Related Bodies .....	8
Control.....	8
<b>DEFINITIONS: DIRECTORS AND OFFICERS.....</b>	<b>9</b>
Who is a director? .....	9
Who is an officer? .....	9
<b>TYPES OF ASSOCIATION .....</b>	<b>10</b>
Why associate? .....	10
<b>Public and Private Companies.....</b>	<b>11</b>
Key differences between public and private .....	11
<b>Changing of company types .....</b>	<b>12</b>
<b>Factors affecting the decision to incorporation .....</b>	<b>12</b>
Types of finance .....	12
Benefits of incorporation .....	12
<b>The nature of share capital.....</b>	<b>12</b>
<b>INCORPORATING UNDER AUSTRALIAN LAW .....</b>	<b>13</b>
<b>What companies can be registered?.....</b>	<b>13</b>
Restrictions on proprietary companies.....	13
Privileges of proprietary companies .....	13
<b>Process of incorporation .....</b>	<b>13</b>
<b>SEPARATE LEGAL PERSONALITY: PRINCIPLES .....</b>	<b>14</b>
Principles .....	14
Consequences .....	14
<b>SEPARATE LEGAL PERSONALITY: PIERCING THE VEIL .....</b>	<b>15</b>
Cloak or Sham .....	15
Agency.....	15
Statutory Exceptions .....	15
<b>CORPORATE CONSTITUTION: REPLACEABLE RULES &amp; GOVERNANCE .....</b>	<b>16</b>
Replaceable Rules .....	16

<b>Choice of governance</b> .....	<b>16</b>
<b>Creating or varying a constitution</b> .....	<b>16</b>
<b>Replaceable Rules</b> .....	<b>16</b>

**CORPORATE CONSTITUTION: ROLES, DIVISION OF POWERS & SPECIAL CONTRACT ..... 18**

<b>Roles and the division of powers</b> .....	<b>18</b>
<b>Division of powers</b> .....	<b>18</b>
Restriction of powers.....	18
Residual power .....	18
<b>The constitution as a ‘special’ contract</b> .....	<b>18</b>
<b>Effect of breach</b> .....	<b>18</b>

**CONSTITUTION: DIRECTORS ..... 20**

<b>Director requirements</b> .....	<b>20</b>
Number of directors.....	20
<b>Eligibility and appointment</b> .....	<b>20</b>
Who can be a director? .....	20
Have they been validly appointed? .....	20
<b>Business of the Company</b> .....	<b>20</b>
<b>Appointing directors</b> .....	<b>20</b>
<b>Removing directors</b> .....	<b>21</b>
<b>Types of directors</b> .....	<b>21</b>
Managing Directors etc. ....	22

**DECISION MAKING: BOARD OF DIRECTORS ..... 23**

<b>When and where are decisions made?</b> .....	<b>23</b>
<b>Single director proprietary companies</b> .....	<b>23</b>
<b>All other companies</b> .....	<b>23</b>
Meeting of directors .....	23
Without meeting of directors .....	23
<b>Irregularities</b> .....	<b>23</b>

**DECISION MAKING: GENERAL MEETING ..... 24**

<b>Powers</b> .....	<b>24</b>
<b>Resolutions</b> .....	<b>24</b>
<b>Resolutions without meetings</b> .....	<b>24</b>
<b>Calling a general meeting</b> .....	<b>24</b>
Who? Calling a general meeting .....	24

When? Notice period .....	25
How? Contents and method of notice.....	25
<b>Directors' Disclosure Obligations.....</b>	<b>25</b>
Duty to provide proper notice .....	25
Duty to disclose material matters to shareholders.....	26
<b>At the General Meeting.....</b>	<b>28</b>
<b>Residual control in the general meeting.....</b>	<b>28</b>
When the board is unable to act .....	28
Ratification of directors' acts .....	29
Dual initiative to litigate in the company's name .....	29
Informal Corporate Acts .....	29
<b>CORPORATE CONTRACTING .....</b>	<b>32</b>
<b>Power of a company to contract.....</b>	<b>32</b>
<b>Enforceable contract.....</b>	<b>32</b>
<b>Method .....</b>	<b>32</b>
<b>Direct.....</b>	<b>32</b>
Did the company bind itself directly? .....	32
<b>By agent .....</b>	<b>33</b>
Was there express actual authority? .....	33
Was there express implied authority? .....	33
Was there ostensible authority?.....	33
<b>Indoor Management Rule.....</b>	<b>34</b>
<b>Statutory assumption rules .....</b>	<b>34</b>
<b>DIRECTORS' DUTIES: COMPANY INJURIES.....</b>	<b>35</b>
<b>Directors' duties element: capacity .....</b>	<b>36</b>
<b>Directors' duties element: reliance on information .....</b>	<b>36</b>
<b>Directors' duties element: liability where duty delegated.....</b>	<b>36</b>
<b>Directors' duties: duty of care (general law).....</b>	<b>37</b>
<b>Directors' duties: duty of care, skill and diligence (s 180 ASIC).....</b>	<b>38</b>
Criminal Liability.....	39
<b>Directors' duties: duty to act in good faith (general law) .....</b>	<b>40</b>
<b>Directors' duties: duty to act in good faith and for a proper purpose (s 181 ASIC).....</b>	<b>41</b>
Criminal Liability.....	41
<b>Directors' duties: conflict: improper use of position (s 182 ASIC) .....</b>	<b>42</b>
Criminal Liability.....	42
<b>Directors' duties: conflict: improper use of information (s 183 ASIC).....</b>	<b>43</b>
Criminal Liability.....	43
<b>Directors' duties: conflicts/secret profits/diversion (equity).....</b>	<b>44</b>

<b>Directors' duties: duty to disclose material personal interest (s 191) (Criminal)</b> .....	<b>46</b>
Criminal Liability <b>ONLY</b> .....	46
<b>Directors duties: misleading and deceptive conduct (s 1041H)</b> .....	<b>47</b>
Criminal Liability.....	47
<b>Directors duties: duty to prevent insolvent trading (s 588G)</b> .....	<b>48</b>
Defences include:.....	49
Penalty .....	49
Criminal Liability.....	50
<b>DIRECTORS' DUTIES: RELATED PARTY TRANSACTIONS (S 208)</b> .....	<b>51</b>
<b>Rule</b> .....	<b>51</b>
<b>Definitions</b> .....	<b>51</b>
<b>Financial benefit</b> .....	<b>52</b>
<b>Exceptions to obtaining member approval</b> .....	<b>52</b>
<b>Obtaining member approval</b> .....	<b>53</b>
Criminal Liability.....	53
<b>DIRECTORS' DUTIES: CRIMINAL LIABILITY (ALWAYS CONSIDER)</b> .....	<b>54</b>
<b>Penalties</b> .....	<b>54</b>
<b>Effect of convictions</b> .....	<b>54</b>
<b>SHAREHOLDER ACTION – SHAREHOLDER INJURIES</b> .....	<b>55</b>
<b>Shareholder action: derivative action (remember indirect benefit via compensation)</b> .....	<b>56</b>
<b>Shareholder action: contract under company constitution (s 140)</b> .....	<b>58</b>
Remedies .....	58
<b>Shareholder action: fraud on the minority</b> .....	<b>59</b>
Alternate grounds .....	59
<b>Shareholder action: oppression (s 232)</b> .....	<b>61</b>
Orders that can be made – s 233(1) .....	61
<b>Shareholder action: directors' fiduciary duty (families and close friends)</b> .....	<b>63</b>
Cases .....	63
<b>Shareholder actions: misleading and deceptive conduct</b> .....	<b>64</b>
<b>REMEDIES: WINDING UP (ALSO ON APPLICATION)</b> .....	<b>65</b>
<b>Winding up: insolvency</b> .....	<b>65</b>
Insolvency .....	65
Effects of insolvency .....	65
<b>Winding up: other grounds</b> .....	<b>65</b>

<b>REMEDIES: CIVIL PENALTY PROVISIONS.....</b>	<b>67</b>
<b>Penalties.....</b>	<b>67</b>
Declaration.....	67
Pecuniary penalty order.....	67
Compensation.....	67
Disqualification order.....	67
<b>REMEDIES: INJUNCTION - ASIC OR SHAREHOLDERS OR THIRD PARTY.....</b>	<b>69</b>
<b>REMEDIES: EQUITABLE AND COMMON LAW.....</b>	<b>70</b>
<b>Common Law Compensation/Damages .....</b>	<b>70</b>
<b>Equitable Compensation/Damages .....</b>	<b>70</b>
<b>Equitable Remedies.....</b>	<b>70</b>
Constructive Trust.....	70
Injunction.....	70
Account of profits .....	70
<b>Bars to relief.....</b>	<b>70</b>
<b>RELIEF: CIVIL PENALTY PROVISIONS .....</b>	<b>73</b>
<b>RELIEF: NEGLIGENCE, DEFAULT, BREACH OF TRUST, BREACH OF DUTY.....</b>	<b>74</b>
<b>CRIMINAL LIABILITY .....</b>	<b>75</b>
<b>Proceedings.....</b>	<b>75</b>
<b>General offence .....</b>	<b>75</b>
<b>Criminal penalties.....</b>	<b>75</b>
<b>Primary corporate criminal liability .....</b>	<b>75</b>
<b>Vicarious corporate criminal liability .....</b>	<b>75</b>
<b>INDEMNITIES .....</b>	<b>76</b>

# PROBLEM QUESTION APPROACH

		Whose injury are we talking about?	
		The Company	Shareholder(s)
Who is litigating?	The company	General law Corporations Act	
	A shareholder	Shareholder action: derivative action Shareholder action: constitution	Articles General law rights Fraud on the minority Oppression
	ASIC	Corporations Act	
	Third Party		

## Generally:

1. Identify the parties, their roles, and their responsibilities? Have they been appointed and correctly constituted etc.? What are their titles? What are their implied roles? What are their roles for the purposes of the statute?
2. work through all possible causes of action then make a judgement at the end about whether it would be worthwhile for the party.

## If advising a third party:

1. look at **corporate contracting** for enforcement of contracts;
2. look at **directors' duties** for breaches that impact third party – can apply for statutory injunction;

## If advising the company:

1. look at **corporate contracting** for enforcement of contracts;
2. look at **corporate constitution** for breaches against the company by directors or members;
3. look at **directors' duties** for injuries against the company;
4. look at **shareholder action** for injuries against the shareholder.

### If advising a shareholder:

1. look at **directors' duties** via **derivative action** for injuries against the company;
2. look at **corporate constitution** for breach of constitution by company or other shareholders;
3. look at **shareholder action** for injuries against the shareholder.

### If advising ASIC:

1. look at **statutory directors' duties** for injuries against the public or the company.

### If advising a director:

1. look at **corporate constitution** for breaches of constitution by company;
2. look at liability for **all directors' duties** for injuries against the public or the company (**ASIC, company or derivative action**);
3. look at liability for **shareholder action** for injuries against the shareholder (**shareholder**).

# DEFINITIONS: CORPORATE GROUPS

## Subsidiaries

- Under s 46, an entity is a subsidiary of another if the other body:
  - controls the composition of the first body's board, that is, if it can appoint or remove all or a majority of directors of the first body (s 47); or
  - is in a position to cast, or control the casting of more than one-half of the maximum number of votes at a general meeting; or
  - holds more than one half of the issued share capital of the first body; or
  - the subsidiary is a subsidiary of a subsidiary.

**Gramophone & Typewriter Ltd v Stanley** – if one buys even all shares of a company, it does not in any way diminish the rights and powers of the directors, or make the property of the company his, as distinct from the corporations. He is merely entitled to dividends on his shares and to vote as per the rights in his shares.

## Related Bodies

- Under s 50, an entity is a related body corporate if it is:
  - a holding company of another body corporate; or
  - a subsidiary of another body corporate; or
  - a subsidiary of a holding company of another body corporate.

**IEL v Blackburn** – 'it can hardly be contended that the provisions of the Act operate to deny the separate legal personality of each company in a group... the creditors of ... a subsidiary company within a group can only look to that company for payment of their debts. They cannot look to... the holding company for payment.

## Control

- An entity controls another entity where it has the capacity to determine the outcome of decisions about the second entity's financial and operating policies – s 50AA(1).
- This will occur where it has a practical influence on a practice or behaviour of the second entity – s 50AA(2).
- It is not enough that a first and third entity jointly have the capacity to determine the outcome of decisions about the second entity's financial and operating policies - s 50AA(3).
- If the first entity is under an obligation to exercise their capacity for the benefit of someone other than the first entity's members, they are not 'in control' of that entity - s 50AA(4).



# DEFINITIONS: DIRECTORS AND OFFICERS

## Who is a director?

- **Common law** - a person who acts as a director or senior manager without legal authority cannot escape liability under statute or the general law by denying that they are a director or officer – *CAC v Drysdale*.
- **Corporations Act** – For the purposes of the Corporations Act, a director is one validly appointed as a director or someone who satisfies the s 9 definition of director:
  - **De facto director** – [Director] is a **de facto director** because they have acted in the position of a director or the directors of the company – s 9. In *Grimaldi v Chameleon Mining NL*, it was held that the nature and extent of the functions to be performed and the constraints imposed on the person will be the decisive factors in determining if the person is a director. If they have a general and unconstrained role that permits them to take an active part in the affairs of the company, it is more likely that the person is a director. [Party] undertook an active part in managing the affairs of the company by [action]. [Party] also had free reign to [action]. Therefore, [party] is a director for the purposes of the act.
    - (*Grimaldi was a consultant, integrally involved in Chameleon’s operations. Court held that Grimaldi was a director.*)
  - **Shadow director** – [Director] is a shadow director because the body of the company is accustomed to act in accordance with their instructions or wishes – s 9. In *Standard Chartered Bank of Australia*, it was held that this ‘shadow’ director provision is made out when the person shows a willingness and ability to exercise control, and actual control over the management and financial affairs of the company. [Party] satisfies the first element by [action]. [Party] satisfies the second element by [Action]. Therefore, [Party] is a director for the purposes of the act.
- **Note: officers** are also liable for most duties.

## Who is an officer?

**Rule** – For the purpose of the act, a person is an officer if they are:

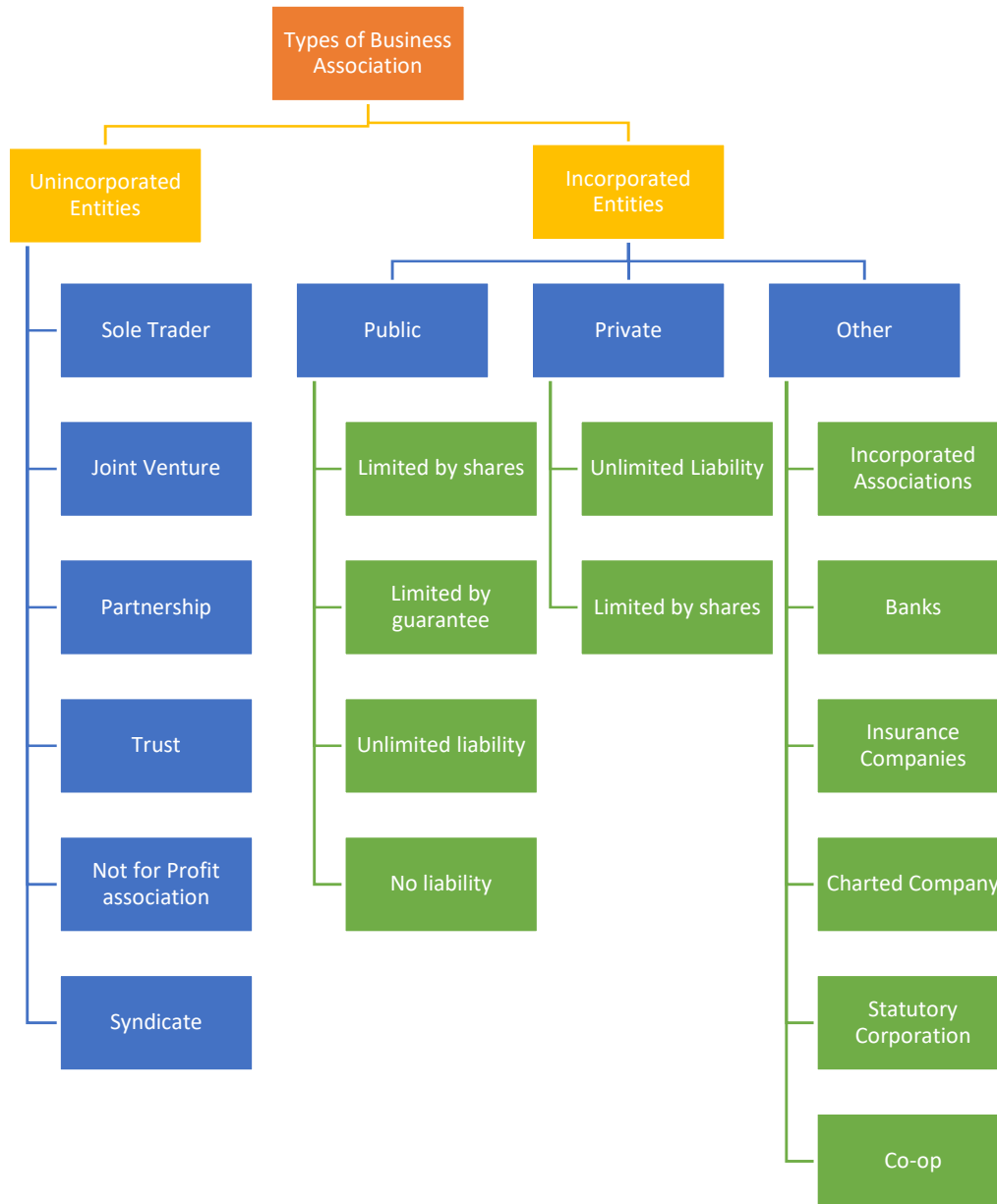
- A director or secretary of the corporation – s 9 ‘officer’ (a)
- A person who makes or participates in making, decisions that affect the whole, or a substantial part, of the business of the corporation – s 9 ‘officer’ (b)(i)
- A person who has the capacity to affect significantly the corporation's financial standing – s 9 ‘officer’ (b)(ii)
- A person in accordance with whose instructions or wishes the directors of the corporation are accustomed to act (excluding advice given by the person in the proper performance of functions attaching to the person's professional capacity or their business relationship with the directors or the corporation) – s 9 ‘officer’ (b)(iii)
- A receiver – s 9 ‘officer’ (c)
- An administrator – s 9 ‘officer’ (d)
- A liquidator – s 9 ‘officer’ (f)

**Application** – Party Action. Therefore, Party is an officer for the purposes of the act.

# TYPES OF ASSOCIATION

## Why associate?

People choose to associate for a number of non-profit goals including charitable, educational, scientific, sporting, professional, or individual objects. Association is also used to enhance private business activity, minimise tax imposts and marshal public funds.



## Public and Private Companies

The two **main types** of companies that can be registered under the *Corporations Act 2001* (Cth) are proprietary or 'private' companies and public companies - s 112.

Key differences between public and private

	Public	Private
<i>Raising money</i>	Can raise money from the public	Can't raise money from the public – s 113(3)
<i>Regulation</i>	Increased regulation	Less regulation
<i>Shareholder limits</i>	No limit	Maximum of 50 non-employee shareholders - s 113; s 45A
<i>Directors</i>	Min. three directors – s 201A	Min. one director – s 201A
<b>Liability Structures</b>		
<i>Limited by shares</i>	A company limited by shares is a company formed on the principle of having the liability of its members limited to the amount (if any) unpaid on the share respectively held by them. If shares are issued as fully paid, their holder has no further obligations to contribute to the debts and liabilities of the company.	
<i>Unlimited liability</i>	There is no limit to the liability of members. If the share capital cannot satisfy creditors, then members may be called to satisfy debts. Not often used, but has the benefit of allowing share capital to be reduced without restriction.	
<i>Limited by guarantee</i>	In practice, employed for non-profit activities. The Act defines it as one 'formed on the principle of having the liability of its members limited to the respective amounts that the members undertake to contribute to the property if it is wound up' - s 9. Members' guarantees can only be charged during the winding up, not during the life of the company. Inconvenient vehicle for a business requiring share capital as it has none. Revenue is raised through fees or loans.	Not available to private companies.
<i>No liability</i>	Only for mining companies. Designed to encourage investment in inherently risky operations. <b>Only really relevant for not fully paid shares.</b> If a company goes bankrupt then the outcome is the same for fully paid shares.	Not available to private companies.
<i>Shares and guarantee</i>	These types of companies can no longer be registered. Developed to address cases where some capital was required to obtain a premises etc.	Not available to private companies.

## Changing of company types

Can be changed through Pt 2B.7 procedures.

## Factors affecting the decision to incorporation

### Types of finance

There are two types of finance, debt and equity. Both can be used to diversify risk.

- Equity – (from shareholders and business activity) – shareholders take risk of company success failure.
- Debt – (from creditors) – creditors take risk of company success or failure.

### Benefits of incorporation

There is complex calculus involved in the choice of form of association. Generally, however, for large enterprise the advantages of incorporation, the transferability of corporate securities and the existence of organised securities markets will compel registration under the *Corporations Act*.

- **Limited liability** – partners are personally liable for the firms debt and their credit may be pledged by a partner acting within the ostensible scope of firm business. Incorporation insulates members' other assets from claims.
- **Perpetual succession** – Unaffected by death or bankruptcy of any member.
- **Financing** – floating securities (float above the assets of the company. The company can still obtain and dispose of assets, until a predefined default).
- **Cost, formality and continuing obligations** – Cannot be freely dissolved like a partnership. This burden of formality is a major cost of incorporation against which the corporate advantages must be weighed.
- **Taxation** – Imputation credits – some complex tax issues.

Example: Engineers in partnership

- The advantages for those engineers of incorporating their business would be:
  - Reduced transaction costs on entry or exit of partners – there is no need to transfer assets or re-document leases, bank facilities, and etcetera each time such an event occurs.
  - If they want to sell the business as a going concern, it will be much simpler
  - They will be able to contract with outsiders using a default limited recourse term, which limits their liability to clients to the assets of the business.

## The nature of share capital

Share capital is a device to allocate risks, rights and functions among participant in a business. In companies that have limited liability, there is the further function of fixing the minimum contributions by members to the liabilities of their company. Shares confer a bundle of rights and are described as a chose in action as the shareholders do not have any legal or equitable interest in the assets of the company.

# INCORPORATING UNDER AUSTRALIAN LAW

## What companies can be registered?

The following types of companies can be registered:

- **Proprietary companies** – Limited by shares | Unlimited with share capital – s 112.
- **Public companies** – Limited by shares | Limited by guarantee | Unlimited with share capital | No liability company – s 112.

### Restrictions on proprietary companies

Limited in size and membership (50 non-employee members) and must not engage in any activity that would require the lodgement of a prospectus.

### Privileges of proprietary companies

- **All proprietary companies**
  - Any proprietary company may register with a single shareholder and trade with a single director – s 114(1)
  - The requirement to hold an annual general meeting only applies to public companies – s 250N
  - All proprietary companies may use the facility of passing shareholder resolutions without holding a meeting – s 249A
  - Proprietary company's stand outside the prohibition upon participation by directors in deliberations in which they have a material person I interest in.
- **Small companies only** (less than \$25m in revenue, assets of less than \$12.5m and less than 50 employees – s 45A)
  - Companies *other* than small proprietary companies must prepare financial statements for each financial year, have those statements audited and lodge them with ASIC and have them publically accessible.
  - Small companies only must prep financial statements and send them to members if:
    - Shareholders with at least 5% of votes direct company to do so – s 293.
    - The company is controlled by a foreign company – s 292.
    - ASIC directs it to do so – s 294.
  - These statements do not need to be lodged with ASIC.

## Process of incorporation

### **General rules:**

- Minimum of 1 member – s 114.
- A proprietary coy must have at least 1 D. The D must ordinarily reside in Australia. A public coy must have a least 3 directors. At least 2 must ordinarily reside in Australia – s 201A(1)-(2).
- Application must be lodged with ASIC and contain all details required by – s 117.
- ASIC gives company CAN, registers company and issues certificate – s 118.
- Company comes into existence on registration – s 119.
- A company is incorporated in Australia and is registered in the state or territory specified in the application – s 119A.
- A person becomes a member, director or company secretary on registration if the person is specified in the application with their consent – s 120.

# SEPARATE LEGAL PERSONALITY: PRINCIPLES

## Principles

- A company registered under the Corporations Act has the legal capacity and powers of an individual – s 124(1); *Salomon v A Salomon (the boot maker case)*.
- A company is distinct from the individuals running it. Therefore, generally, acts of the directors or managers as organs of the company are ascribed to the company - *Salomon v A Salomon*.
- The property of the corporation is distinct from that of its members – *WS Holdsworth, A History of English Law*.

## Consequences

- Owners, managers and employees can wear different hats. They can act in different capacities – *Lee v Lee's Air Farming*.
- Members, even a controlling shareholder, can contract with the company – *Lee v Lee's Air Farming (he was an employee as well)*.

# SEPARATE LEGAL PERSONALITY: PIERCING THE VEIL

There are some cases in which departure from the doctrine must be made so that an **act, omission, right, privilege, duty or liability** of a company can be treated as one of a director or manager in place of, or in addition to, the company. Only occurs in exceptional circumstances, the company is made transparent so the persons behind it can be seen as the persons to whom the corporate right, privilege, duty or liability can be ascribed.

This can occur where:

- The company is a mere cloak or sham – **Gilford Motor Co v Horne; Jones v Lipman**.
- Agency relationship – **Smith, Stone & Knight**.
- Statute – when a company incurs a debt while insolvent – **s 588G,H V-X**.

## Cloak or Sham

**Rule** - a company is a mere cloak or sham whereby the company structure is used to enable another person to avoid existing legal responsibilities - **Gilford Motor Co Ltd V Horne**.

- In order for exception to apply, there must be evidence of impropriety – **Jones v Lipman**.
- This will be easier to prove where there is actual subjective dishonesty – **Kensington International v Congo**.

## Examples

- Company was created to avoid non-compete clause – **Gilford Motor Co**.
- Avoid equitable remedy in relation to property sale to wholly owned company – **Jones v Lipman**.

## Agency

**Rule** - there is an agency relationship between a parent company and a subsidiary and the subsidiary is carrying on its business as the business of the parent company – **Smith, Stone and Knight**.

- The case established the following dicta:
  - Were the profits treated as the profits of the parent?
  - Where those conducting the business appointed by the parent?
  - Who was the head and brain of the enterprise?
  - Did the parent make all strategy, tactics and capital d?
  - Did the parent make profit by application of its skill and direction?
  - Was the parent in effective and continual control?

## Statutory Exceptions

Several provisions in the **Corporations Act 2001 (Cth)** contain directions to pierce the veil of incorporation.

- **When debts are incurred by the company when it is insolvent** or its solvency is impaired by incurring that debt. Its directors are exposed to personal liability for those debts where they knew or ought to have known of the insolvency – **s 558G**
- **Similarly, where the company is a subsidiary of another company**, that holding company may also be made liable in relation to those debts **where it knew or ought to have known of the state of its financial affairs** – **ss 588V-588X**.