

CORPORATE PERSONALITY AND LIMITED LIABILITY

1. THE DOCTRINE OF CORPORATE PERSONALITY

The distinct status of a business organization that has complied with law for its recognition as a legal entity and that has an independent legal existence from that of its officers, directors, and shareholders.

Corporations Act (2001)	
s 124	A company has the legal capacity and powers of an individual... [as well as] all the powers of a body corporate, including the power to... issue/cancel shares; grant security interests in uncalled capital; do anything that it is authorised to do by any other law
s 125	If the company has a constitution, it may contain an express restriction on, or a prohibition of, the company's exercise of its powers. If a company has a constitution, it may set out the company's objects. <u>An act of the company is not invalid merely because it is contrary to an express prohibition in the constitution, or beyond the objects stated</u>
s 201A	Proprietary company must have at least 1 director who ordinarily resides in Australia Public companies must have at least 3 directors, 2 of whom ordinarily reside in Australia

2. CONCEPTS OF SEPARATE CORPORATE PERSONALITY AND LIMITED LIABILITY

a. Separate Corporate Personality

- A company is a type of business structure that, through registration obtains the rights and powers of a natural person, the 'separate legal entity principle'. This is recognized in Corporations Act 2001 (Cth) (CA) s 124.
- Strictly speaking, **this is not the same thing as limited liability** that shareholders receive under a different provision (s 516).
- A company becomes a separate legal entity only after it has been formally incorporated by registration under the Corporations Act 2001 (s 119).
 - Registration creates a separate legal entity, which facilitates limited liability.
- Separate legal entity principle should not, however be confused with limited liability. Limited liability came in the 19th century with the Limited Liability Act 1855 (UK). (LLA)

b. Limited Liability

- Corporate personality serves the function of marking out an asset pool against which creditors of the enterprise have prior claims
 - Entity status partitions this asset pool from the personal assets of stakeholders
- Piercing the veil typically involves breaking the partition to expose the personal assets of shareholders and directors to the claims of the firm's creditors
 - Since the liability of shareholders to contribute to this asset pool is limited to the amount unpaid on shares held, the risk of business failure may well fall upon company's creditors
- Unfair to impose unlimited liability on shareholders where they are not directly responsible for the acts of the corporation
- Creditors are better risk bearers than shareholders, and can bargain for protection

Key Arguments in favour of limited liability	
Encourages investment	<ul style="list-style-type: none"> • Limited liability encourages investment by those who have no interest in or capacity for management participation • Unlimited joint and several liability would significantly disincentivise investment by passive investors
Division between ownership and control	<ul style="list-style-type: none"> • Limited liability represents a rational response to the division between ownership and control
No need to monitor fellow shareholders	<ul style="list-style-type: none"> • Limited liability relieves shareholders of the need to monitor fellow shareholders capacity to contribute proportionately in the event of insolvency
Encourages liquidity of share capital	<ul style="list-style-type: none"> • Limited liability encourages free liquidity of share capital • This both reduces the cost of capital for the company, and creates an accountability mechanism — as poor performance will be reflected in stock price decline, which will stimulate acquisition of control by a party which believes it can achieve superior returns
Makes market pricing of shares effective	<ul style="list-style-type: none"> • Sharemarket price mechanism will only be effective if the price reflects the worth of the share itself, and not the shareholder's financial capacity to contribute to the company's deficiency

	<ul style="list-style-type: none"> • By impersonalising the share, it can trade at a single price • Unlimited liability regime would mean that the value of the shares is inherently attached to the shareholder
Encourages risk-taking	<ul style="list-style-type: none"> • Companies can safely invest in projects with prospects of significant returns, but also with significant risk exposure • Directors have more potential to start-up businesses
Encourages portfolio diversification	<ul style="list-style-type: none"> • Shareholders have a greater inclination to diversify their portfolios under a limited liability model
Key Criticisms	
<ul style="list-style-type: none"> • Benefits to shareholders are matched by risks to creditors - informational asymmetries • Traditional justifications for limited liability are absent in closely held corporations and subsidiary companies • Tort claimants against a company may be more vulnerable than contract creditors, who can bargain for desired protections and a rate of return commensurate with the risk • Moral decisions often blurred by economic demands and the anonymity of group decision • Can encourage excessive risk-taking <ul style="list-style-type: none"> ○ Directors feel like they can hide behind corporate personality 	

Salomon v A Salomon & Co Pty Ltd [1897] AC 22

Principle: A company exists as a separate legal entity- separate to its members and separate to its directors. Shareholders of a company have limited liability and cannot be liable for the debts of the company.

Facts:

- Mr Salomon ran a successful leather business as a sole trader. He set up and registered a company called A Salomon & Co Pty Ltd with 20,007 shares (one to each of his sons and wife).
 - Share capital consisted 40,000 shares – only issued 7
- S sold shoe business to the company in consideration of money. Company pays via 3 methods:
 - 1. Equity financing: 20,000 + 1 shares (\$20,000)
 - 2. Debt financing: debenture (loans) secured by a floating charge covering all assets of the company (\$10,000)
 - 3. Cash (\$9000)
- Mr Salomon was the majority shareholder and the primary creditor was owed \$10,000 under the debenture when the company was wound up. Company goes into liquidation. On sale of the assets, the sum realized was less than the amount of the debentures held by Mr Salomon, and the unsecured creditors received nothing.
- The liquidator on behalf of the company is suing Mr Salomon.

Issue: Should Mr Salomon's secured debt of \$10,000 take precedence over unsecured creditors who were owed approximately \$11,000?

- Generally, company law prioritises secured debt in the event of a winding up
- Unsecured creditors would get nothing if all the assets were exhausted to satisfy secured creditors.

Held:

Trial Judge: Agency

- The company was a mere agent or alter ego of Mr Salomon and thus Mr Salomon was liable for the company's debts
- The debentures issued to Mr Salomon were invalid on the basis of fraud
- The transfer of the business was said to be based on fraud; and
- Alternatively, the liquidator claimed \$20,000 for Mr Salomon's shares on the basis he had paid nothing for.

Court of Appeal: Trustee

- Held that Mr Salomon should pay the creditors. S was trustee of company – had high degree of company thus S must indemnify the company (beneficiary)
- Mr Salomon had abused the privileges of incorporation and limited liability provided by the Company's Acts
- These should only be enjoyed by '**independent bona fide shareholders**' who had a mind and will of their own and were **not 'mere puppets'** of the individual who carried on his business in the same way as before, when he was a sole trader
 - Judges are essentially redrafting the legislation, 'bona fide' is not in the statute

House of Lords: Found in favour of S

- 7 subscribers each must hold at least 1 share. Mr Salomon has complied and nothing to suggest that they need to have a mind and will of their own.
 - Motive behind becoming a shareholder is not a legitimate line of inquiry
 - WRT Fraud: When all the shareholders are perfectly cognisant of the condition under which

the company is formed, cannot contend that the company is being defrauded

- Therefore, Mr Salomon has made a company and is regarded as a secured creditor.
- Lord MacNaughton at 51, 'The company at law is a different person altogether from the subscribers to the memorandum; and, though it may be that after incorporation the business is precisely the same as it was before, and the same persons are managers, and the same hands receive the profits, the company is not in law the agent of the subscribers or trustees for them. Nor are the subscribers as members liable, in any shape or form, except to the extent and in the manner provided by the Act.'
- **A company exists as a separate legal entity, separate to its members and separate to its directors**
- So... the fact that a **company, which is properly formed, is totally controlled by one person doesn't establish agency.**

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

Principle: A person can operate in a dual capacity in a company. Company is separate even from controllers.

Facts:

- Mr Lee established a company to carry on an aerial spraying business. Lee was the controlling shareholder, governing director and also an employee pilot of the company when he was killed in a plane crash. Lee's wife sought compensation under a worker's compensation insurance policy that the company had maintained pursuant to its statutory obligations.

Issue: Mr Lee as governing director, could he also be employed?

- A 'worker was defined as someone who works under a contract of service with an employer.

Held:

- CA rejected the widow's claim on the basis that because Mr Lee was the governing director, who had full control, he could not also be the company's servant.

Privy Council:

- At the relevant time, Lee was piloting an aeroplane belonging to the company, carrying out the operation of top-dressing farm lands from the air → paid wages and these were recorded in the company's books
- The mere fact that someone is a director of a company is no impediment to his entering into a contract to serve the company
- Valid contract: Offer, acceptance, consideration and agreement (meeting of the minds)
 - K of employment – meeting of two legal minds – company has legal capacity and L has legal capacity and that is the K
 - Two legal person can share same legal brain acting in different legal capacities
 - L in his capacity of director, first action is to hire L the natural person
- Mr Lee was an employee of the company, **which was not in any way inconsistent with his other capacities of shareholder and director**, and therefore Mrs Lee was entitled to compensation under the insurance policy. The court stated (at 25): 'It is a logical consequence of the decision in Salomon's case that one person may function in dual capacities.'

Question to think about: What if the dual capacity was conflicting in nature?

3. PIERCING THE VEIL OF INCORPORATION

- At general law, there is no unifying principle for piercing the veil ONLY situations where directors were liable for their company's rights/liabilities.

What is the Corporate Veil?

- **s 124: Legal capacity and powers of company**

The 'corporate veil' exists once a company is registered and it separates the company from the people who formed it (and from those who become its members).

Company		Members
Company is its own separate legal entity with its own assets, liabilities and contracts	VEIL	<ul style="list-style-type: none"> • Own shares but not a proprietary interest in the company's assets • May also be a creditor, debtor or director of the company

There is **no common unifying principle**, which underlies the occasional decision of courts to **pierce the corporate veil**. Although an ad hoc explanation may be offered by a court (ONLY situations where directors were liable for their company's rights/liabilities), there is **no principled approach to be derived from the authorities** — Rogers J in *Briggs v James Hardie*

- The principal cases, wherein the veil of incorporation has been pierced, tend to concern fraud or improper conduct, agency, and the limited recognition accorded to the unity of the enterprise of group of companies under common ownership
 - May be misleading to think of these as categories
 - ‘They **reveal no consistent principle** beyond a refusal by the legislature and the judiciary to apply the logic of the principle laid down in *Salomon* where it is too flagrantly opposed to justice, convenience, or [tax]’
- Further, several **statutory provisions** contain direction to pierce the veil
 - Usually where debts are incurred by the company when it is **insolvent, or its solvency** is impaired by incurring that debt
 - **Directors** will be exposed to personal liability for those debts where they knew or ought to have known of the insolvency — s 588G
 - Where the **company is a subsidiary**, the holding company may be liable for the subsidiary’s debt where it knew or ought to have known the state of its financial affairs — s 588V-X

a. At Common Law

i. Fraud or Improper Conduct

- The use of a company by its controllers in an attempt to **avoid an existing legal duty** that otherwise falls on the controller personally.

The whole purpose (intention) of incorporation must be to evade existing legal obligation (NOT future) If and only then will **equity step in to rightly do what ought to be done.**

Gilford Motor v Horne [1993] 1 CH 935 Court of Appeal, England and Wales

Principle: The corporate veil may be lifted where the company is established to avoid a pre-existing legal obligation (Claim for injunction)

Facts:

- Horne had a restrictive covenant in his employment contract that prevented him from competing with the business at any time during or after his employment.
- After Horne’s contract was terminated by agreement, he set up a company competing against Gilford Motor Co called ‘JM Horne & Co Ltd’ and consisted of his wife and son. Horne was effective manager and controller of the business.
- GM applied for injunction to enforce the restrictive covenant and prevent Horne from competing against GM.

Issue: Could Horne avoid the restrictive covenant in his contract by running his competing business through a company?

Held:

- Horne had a pre-existing contract (continuing condition after he ceased his contract)/legal obligation. He purposely incorporated to avoid the restrictive covenant.
- Horne’s attempt to use the corporation to avoid his legal obligation not to compete with Gilford Motor justified lifting the corporate veil.
 - ‘*The company was formed and was carrying on **business merely as cloak or sham** for the purpose of enabling Horne to commit the breach of the covenant that he entered into deliberately with the plaintiff on the occasion of and as consideration for his position as MD.*’
 - Aside: The problem with calling a company a sham is that if a company is a sham, then no injunction can be issued against it since it does not exist.
- Merely preventing the parties from not complying with existing legal
- **Distinguishing features to *Salomon Case***
 - The point of incorporation was to avoid an existing duty
 - The sole purpose was to avoid the duty.
- Better method of dealing with this situation was in *Garbutt Business College*
 - The facts are almost identical except it is a college – H is a popular teacher with a restrictive covenant
 - Court comes to the same conclusion – injunction can be awarded against H’s company
 - Against H himself for breach of covenant due to the K signed
 - Against H’s company – was not declared a sham, rather relied on economics law
 - Within tort, cannot interfere with contractual relations
 - H’s company engaged in wrongful interference with full knowledge that H had a restrictive covenant and knew full well that H would be breaching H’s contract with the college
 - This knowledge is imputed through the natural persons H
 - Thus there is no veil piercing.

Jones v Lipman [1962] 1 ALL ER 442 (English HC, Chancery Division)

Principle: Equitable remedies (specific performance) will be rewarded to remedy an abuse of the corporate form where a company is set up to avoid an existing legal obligation.

Facts:

- Lipman entered into a **contract to sell his house** to Mr and Mrs Jones. However, prior to completion of the sale, Lipman decided that he did not want to proceed with the sale, which Jones refused and threatened to bring court action seeking specific performance if Lipman failed to complete. In an attempt to keep control of the house, he entered into a further contract to transfer the home for a lower price to a company called Alamed whose directors were Lipman and a clerk (although no evidence of any shares actually being issued).
- Lipman wrote to Jones's solicitors advising that he had sold the property. He admitted that this constituted a breach of contract and offered to pay damages suffered by the Jones as a result of this breach. Mr and Mrs Jones were not prepared to accept damages and sought specific performance of the contract, against Lipman.

Issue: Could Jones obtain an order of specific performance against third parties to enforce the contract?

Held:

- Lipman sought to rely on Salomon, arguing that the company was now owner of the property. The Joneses relied upon Gilford and the court accepted this. → ordered specific performance
- The court described the company as:
 - *'A device, a sham, a mask which he holds before his face in an attempt to avoid recognition by the eye of equity.'*
- Better method of dealing with this situation
 - Once again there is no need to call Alamed a sham
 - The company has knowledge of the transaction between L and J, which can be imputed through L the natural person. Thus there would there be a priorities claim and the property would be sold to J.

Fair Work Ombudsman v Ramsey Food Processing [2011]

Facts:

- The Ramsey Group of companies was set up for the purposes of running an abattoir. Ramsey was the guiding mind of the group. Ramsey Food Processing operated the abattoir. Tempus Holding supplied staff to Ramsey Food under a purported labour-hire arrangement.
- In 2008, Tempus notified all staff that their employment was terminated and went into voluntary administration. Substantial money was owed to the employees.
- The Fair Work Ombudsman initiated proceedings against Ramsey Food for the outstanding employee entitlements — on the basis that Ramsey was the true employee

Held:

- Court held that Ramsey was the true employer and liable to pay the outstanding employee entitlements
- The finding was based on the fact that Tempus was completely reliant upon Ramsey
 - No assets
 - No management structure
 - Did not operate as an independent business
- Tempus was a corporate shell to protect Ramsey Food from liability from employees

Prest v Petrodel Resources Ltd [2013]

- Distinguished between the concealment principle and the evasion principle
 - **Concealment principle** - "The concealment principle is legally banal and **does not involve piercing the corporate veil** at all. It is that the interposition of a company or perhaps several companies so as to conceal the identity of the real actors will not deter the courts from identifying them, assuming that their identity is legally relevant. In these cases the court is not disregarding the "facade", but only looking behind it to discover the facts which the corporate structure is concealing".
 - **Evasion principle** — the court may disregard the corporate veil if there is a **legal right against the person in control of it which exists independently of the company's involvement**, and a company is interposed so that the separate legal personality of the company will defeat the right or frustrate its enforcement
 - Many cases will fall into both categories, but in some circumstances the difference between them may be critical
- 'There is a limited principle of English law which applies **when a person is under an existing legal obligation which he deliberately evades or whose enforcement he deliberately frustrates by interposing a company under his control**. The court may then pierce the corporate veil for the purpose, and only for the purpose, of **depriving the company or its controller of the advantage that they would otherwise have obtained by the company's separate legal personality ...** I consider that if it is not necessary to pierce the corporate veil, it is not appropriate to do so, because

on that footing there is no public policy imperative which justifies that course.'

ii. Agency

Smith, Stone & Knight v Birmingham Corp [1934] King's Bench Division

Principle: 6 Questions to identify agency relationship between parent company and its agent (Controversial)
If a parent is in effectual and constant control, inter alia, of a wholly-owned subsidiary (such that at a moment's notice the subsidiary's business could be taken over by the parent), then the subsidiary may be an agent.

Facts:

- SSK, which operated a paper manufacturing business, bought out the partners of a paper distribution business, which it then had incorporated. The paper distribution business remained under the full control of SSK:
 - Directors were appointed by SSK
 - All the profits went straight to SSK (without declaration of a dividend)
 - All the shares were effectively owned by SSK
- The subsidiary's business was operated on land owned by SSK.
- The local council (Birmingham Corp) purchased the land to carry out public works.
- SSK applied for compensation for the cost of relocating the subsidiary's business.
- Compulsory acquisition laws provided that tenants without a long-term lease were not eligible for compensation. The subsidiary only had a temporary lease.

Issue: Who was the proper party to sue for compensation: SSK or the subsidiary?

Held:

- The degree of control and dominance that the parent company had over the subsidiary established an agency relationship such that the parent, SSK, was entitled to compensation for disturbance to the business operated by the subsidiary.
- Agency relationship is more likely to be established where a benefit is being conferred
- Atkinson J: Checklist approach to see if there existed an agency relationship
 - 1. Were the profits treated as the profits of the parent?
 - 2. Were the persons conducting the business appointed by the parent?
 - 3. Was the parent the head and the brain of the trading venture?
 - 4. Did the parent govern the adventure, decide what should be done and 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? (This was the important one here, since SSK was calling all the shots)

* All questions must be answered in the affirmative.

- 1) This checklist approach has been highly criticized
- 2) Comparison wrt *Salomon*:
 - a. *Salomon* was about piercing the veil to get to an individual. We don't want to make individuals personally liable but maybe it's not so critical in a corporate group set-up.
 - b. Freund argues that *Salomon's Case* was decided on capitalist control, not functional control and that the Court won't pierce when it's capitalist control. However, wasn't *Salomon* also in functional control of his company? This suggests this argument is weak
 - c. The context is different. It's not a creditor of BW trying to get paid by SSK. Here the company itself is trying to say that it shouldn't be treated as a separate legal person.
 - i. But Gower suggests that you'd find these 6 points in every WOS but that the Court will not always pierce the veil of a WOS.
 - ii. You could argue that here Atkinson J basically found that BW was a sham, and thus could not really be the agent of SSK (but it is arguable the other way too).
- 3) Another point to add to Atkinson's list, which is used in Australia, may be: Was the subsidiary capable of standing separately from the parent company? Or was it under capitalised to the extent it was on a drip feed? *Re FG (Films) Ltd [1953]* – not sure if applies in Australia
- 4) Exception (reason why agency is not used): In Australia, see Rogers AJA remarks in *Briggs v James Hardie*: Just because you have a WOS doesn't mean you can do away with the corporate veil. Mere dominance is not enough.
- 5) ALSO HoL in *Soloman* says no.
- 6) Compare the facts here with those in *DHN Food Distributors Ltd [1976] EWCA*, below.

Re FG Films [1953]

Facts:

- FG films wanted *Monsoon* registered as a British film. It applied to be declared as the 'maker' under the Cinematograph Films Act

- The Board of Trade refused because it was made by the American 'Film Group Inc'. The American company had promised to finance and provide facilities to the UK company for making the film.
- 90/100 share were held by an American director and 10 by a British one. No shares were held by the third director, who was also British.

Issue: Was the company correct in disallowing Monsoon to be registered as a British film?

Held:

- X was, in fact, the agent and nominee of FG. Thus, it was not entitled to the subsidy.
- The judge looked at all of the facts and decided that it would be ludicrous to allow FG to masquerade as X's agents, when FG was the bigger, established company which had actually made the movie. X was FG's agent in trying to get the tax advantage.
 - The participation was so small as to be practically negligible
- This relationship is exactly the opposite of *Smith Stone & Knight*.
- Here they tried to get the parent company to be the agent of the subsidiary.
- **Critique:** This case could arguably fit in under the improper conduct category studied earlier.

iii. Corporate Groups

Corporate group — 'a number of companies which are associated by common or interlocking shareholdings, allied to unified control or capacity to control'

- Competing conceptions:
 - Group as a family of subsidiary companies under a holding company that has majority ownership or voting control of the subsidiaries; or
 - Group as an economic entity of a parent and its controlled entities under a broader and more generally expressed definition of corporate control

Corporations Act (2001) s 46 – What is a subsidiary?

A subsidiary is defined as "a company in which another company:

- **controls the composition of the board**, or
- is in a position to cast, or control the casting of, **more than 50% of votes in the general meeting**, or
- Holds **more than 50% of the share capital.**"

- A company controls the composition of the board of a second company if it has the power to appoint or remove all or the majority of the directors of that company, even if only with the consent of another person
 - A company is deemed to have this power if:
 - No person can be appointed to the board of the second company without the exercise by the first company of the power in favour of that person (the power might derive from the company's constitution or an agreement between members); or
 - The person's appointment as director of the second company follows necessarily from the person being a director of the first (typically by provision in the constitution of the second company)
- A holding company that is not itself another company's subsidiary is the **ultimate holding company**: s 9.
- The norm formally is that the separate personality of each company is not diminished by its membership of the group. Thus directors of a company within a group are obliged to act by reference to their perception of its interests, and not those of the group generally.
- Absent special contractual arrangements, statutory obligations or veil piercing, creditors of each company within the group are entitled to look only to the resource of that company for the discharge of their debts and obligations.
- **Australian courts have tended to favour form over substance in this area**
 - **'The fundamental principle is that each company within a group is a separate and independent legal entity'** — *Walker v Wimborne (1976)*

Why have corporate groups? In light of the principles laid down in **Salomon's Case**, there are two main implications in the context of corporate groups:

1. To **insulate the parent**. Contracts between creditor/subsidiary are only between those parties and thus the parent is not privy to the contract. Hence, if the subsidiary defaults, the creditor can only reach into the assets of the subsidiary.
2. Directors of the subsidiary company **owe their fiduciary duties only to the subsidiary company**, not the parent.

DHN Food Distributors v London Borough of Tower Hamlets [1976] → UK Case

Principle: In a compensation case, the question is: Has the parent been disturbed in its possession and enjoy

of the business?

Facts:

- Sub A owned land and Sub B owned the operating vehicles, while the DHN owned/ran the business. In this way, various assets were split between members of the corporate group.
- Subsidiary A directors were DHN's. Subsidiary A had no business - its only asset was the land & DHN was licensee.
- Council compulsorily acquired the premises, and DHN had to close down. Compensation was already paid to Sub A. DHN could only get compensation for 'disturbance of the business' if it have more than a license interest.
- However, the agency argument was difficult here, in contrast to *Smith Stone & Knight*, because the WOS owned the land here, so it was difficult to say it was the agent of the parent, which was in fact carrying on the business.
- The situation was more one of horizontal integration (firms working together) rather than vertical integration as in the agency examples. That is, if the corporate group was structured differently, the agency argument in *Smith Stone & Knight* could have been applied.

Issue: Who was the proper party to sue for compensation: DHN or the subsidiary?

Held:

- Held per Denning LJ: Compensation should be allowed here. That is, the corporate veil of the group was pierced. Lord Denning argued the group structure was essentially the same as a partnership but no clear reasoning for this was presented. Rather than looking at them separately, he said to look at them together. **All 3 economic entities were treated together so legally they should also be treated together.**
- When a parent company owns all the shares of the subsidiaries - so much so that it can control every movement of the subsidiaries, these subsidiaries are bound hand and foot to the parent company and must do what the parent company says
- Held per Goff LJ: Acknowledged that not in every group situation will the court pierce the veil. But here:
 - (1) The subsidiary was wholly-owned;
 - (2) the subsidiary had no separate business operations; and
 - (3) the question really was whether the owners of the business had been disturbed in their possession and enjoyment of the business (concerned compensation).
 - This was made out.
- What is the context in which we're being asked to pierce the veil? This is quite a specific compensation case.
- **Critique:** This UK decision is very liberal. It is really letting the corporation have its cake and eat it too – by allowing it the tax benefits of the group structure – but treating it as a single unit when it applies for compensation.
- **In Australia, the HCA in *Walker v Wimborne* asserted that each company within a group is a separate and independent legal entity, and that it was the duty of the directors of each company to consult its interests and its interests alone in deciding whether payments should be made to other companies.**

***Industrial Equity v Blackburn (1977) HCA* → Leading Aus Case**

Principle:

- There is a strict demarcation between the profits and assets of the parent and its subsidiary.
- In corporate groups you CANNOT mix the profits of the parent with the subsidiary.
- Each subsidiary in the corporate structure is its own separate legal entity. (Liability stays within the separate legal entity)

Facts:

- Parent company was alleged to have been giving dividends calculated not solely from its profits, but from the profits of itself and its subsidiary, which was "technically" not allowed
 - You can only distribute dividends at the maximum of your profits but they wanted to distribute more than their profits of themselves and the subsidiary together.
- While they could have just transferred the profits to the holding company, this would have incurred tax.

Issue: Whether in ascertaining the amount of profits available for distribution by a holding company by way of dividend it is correct to look at the profits of the holding company itself or to the group profit as disclosed by the consolidated accounts?

Held:

- The Court took a **strict approach**. That is, the corporate veil of the group was NOT pierced. The parent company should have called a shareholder's meeting of its subsidiary to resolve to declare its profits to be paid as dividends of the parent. No adding the subsidiary's profits to the parent company.
- **A company that seeks to pay a dividend must draw only on its own profits and cannot use the profit of other related companies because all companies are separate legal entities (there must**

be some formal process)

- **Corporate veil applies equally to corporate groups as it does to individuals**
- **For directors, the duties are owed to the company — not the group**
- **Creditors have recourse only to the company with which they have contracted**
- Notes:
 - Limited liability appears weaker in the context of a corporate group since before, limited liability of a corporate group operated to provide multiple layers of insulation from liability; piercing one layer does not expose the ultimate shareholders to personal liability. So the risk-taking justification for limited liability doesn't apply. Moreover, it allows for the corporate boundary problem which encourages too much risk-taking while insulating the parent.
 - While the law regards each company as a separate legal person, that's not how they operate in reality.
 - Shareholders in a group are not atomistic, unequal contributors of capital but a cohesive group.

Quintex Australia Finance v Schroders Australia (1990) NSWSC

Principle: If you contract with one of the members of a corporate group, you cannot impose liability on the other group companies.

Facts:

- Note: At this time there was no general prohibition for insolvent trading – this case calls for the ban on insolvent trading – now in the Corporations Act s 588V,G.
- S was a stockbroking firm with various subs of the Q corporate group being their clients.
- There was a forward exchange contract on behalf of one of the sub, which went wrong and caused S a loss.
- S took the money from one of Q's company's accounts but Q alleged that was the wrong company in the group. An action was brought against Q (arguing that Q was liable). Q argued it was not liable, but rather that one of its subsidiaries (QTL) was the relevant contracting party.
 - Note: In this case there were no cross-guarantees between the relevant companies in the group. Cross-guarantees are common commercial practice for creditors to protect their interests.
- From the facts S knew they had contracted with QTL.
 - EVEN THOUGH during discussion it seemed like the D had always treated their client as Q and did not differentiate between companies in the group. BUT when recording the forward contract transaction the code given was QTLBR1. On the other hand, when D asked who they should look into for credit limits, the response was 'it does not matter to us, choose whichever company you feel the most comfortable with'.

Issue: Had S entered the contract with the plaintiff? Or QTL or another one from the Q group?

Held: On the facts, S had contracted with QTL so Q was able to avoid liability. **That is, the corporate veil of the group was NOT pierced.**

- Creditors must look to the specific company within a group with whom they made a contract for its enforcement, despite the practice of the companies acting as a group for business purposes.
- S's argument was that they were confused and were given various instruction from people at different subs – HOWEVER this was NOT enough, S were complex bankers and should be able to differentiate

Note:

- But Roger CJ: His Honour suggested the law may need to be reformed such that all the assets of a corporate group should be aggregated (but note: this would drive a truck through separate personality principles). His Honour noted the difficulty for some parties to determine which company in a group they are dealing with, although in this case he believed S did know.
- Analysis: Such a reform may be a good thing for lazy creditors (who are protected if they invest in a subsidiary which fails) but an undesirable consequence would be that the assets of prudent creditors (who invested in profit-making companies in the group) would be sucked up by failing subsidiaries. Further, it is prudent investing for creditors to check for, or demand, cross-corporation guarantees when dealing with members from a corporate group.

iv. Other Categories

- In torts, veil piercing may be allowed. (*Briggs v James Hardie (1989)*)
- **Starting Point:** There is no general principle. BUT from the facts of the cases you can draw some analogies. In Australia there is no rule.
- In *Briggs*, the Court says they may treat it differently for torts and contracts claims (Was in obiter).

Briggs v James Hardie & Co Pty Ltd (1989) NSWCA

Principle:

- (1) In torts: Where a subsidiary is a tortious creditor, its parent may also be liable. (Recognises that it would not be applicable in cases where the injured person is an employee BUT CA: employees don't

have real input in determining how businesses conduct themselves)

- (2) General Principle: To lift the corporate veil, there only needs to be sufficient evidence to make an argument that the veil should be lifted. (Mere dominion and control over another is entirely too simplistic)

Facts:

- Briggs contracted asbestosis from working with asbestos over several years for companies associated in one way or another with James Hardie & Co (the relevant asbestos businesses were transferred to several different companies during the time gap between when Briggs commenced working with asbestos to the time when he actually commenced legal action seeking compensation for his asbestosis).
- Briggs attempted to sue a number of the companies that were involved in the asbestos production business that he had worked for; however, his claim was made outside the limitation period. Briggs then sought an extension of time to sue for negligence and was granted permission with regard to some of the companies he sought to sue, but not others. Briggs then appealed to the NSW Court of Appeal.

Issue: Could the corporate veil be lifted so as to allow Briggs to make a claim against all the companies involved (that is, more than the company that presently owned any legal liability?)

Held:

- The majority of the court found that it was arguable that Briggs could make a claim against the companies and therefore he should be given an extension of time to bring a claim against the companies.
- Rogers CJ: 'The state of the law regarding when a court will lift the corporate veil was uncertain. His honor also considered at length the special disadvantage that tort victims (as opposed to contract claimants) have in relation to the limited liability and separate legal entity principles.
 - Court should be more sympathetic to tort claimers since they are effectively unsecured creditors as they are unable to negotiate with their employer the conditions of what shall occur when they fall sick
 - No settled principle for piercing the veil
- Note: This case does NOT establish a basis for tort claimers for veil piercing
 - It must be remembered, however, that Briggs was not a case concerning the merits of lifting the corporate veil (that is, **this case does not state that the corporate veil will be lifted in all tort cases**).
 - The Briggs case concerned whether the court should allow a negligence claim to be made after the time limited had passed, and therefore the **court only had to be satisfied that the evidence presented could have produced an arguable claim against the group for companies** (that is, the court did not need to be satisfied that the corporate veil should actually be lifted, but only that there was sufficient evidence to make an argument that the veil should be lifted).
- Possibly principles for determining whether the veil should be lifted.
 - 1. Mere dominance in and of itself is not enough (Not enough to establish agency) – Does not say what level is required.
 - 2. May take into account undercapitalisation – Not sure if this applies in Australia.
 - 3. Need to consider nature of action: (Policy Argument)
 - If torts, there is less control as to you do NOT know who your party is.
 - If contracts, there is more control since you DO know who your party is.
 - Briggs was an employee so he had an employment contract with James Harde. But there is not that much control they have to day-to-day operations of the company. Therefore better with tortious than contractual claims. BUT piercing corporate veil is difficult.
- **Control (A method to get around piercing the veil):**
 - Direct duty of care owed by company to the individual. (Lots of control)
 - Parent company had given its subsidiary its code of conduct and the subsidiary follows it.

CSR Ltd Wren [1977] NSWCA

Principle: DOC owed by parent (not really piercing veil) directly to Plaintiff

Facts:

- Mr Wren was awarded damages in the Dust Diseases Tribunal, for illness caused by inhaling asbestos while employed by a wholly owned subsidiary of CSR Ltd
- The subsidiary was described as part of CSR's Building Materials Division and its board of directors and management staff were all employees of CSR
- CSR board meeting regularly made routine decisions concerning the subsidiary's operations, and working conditions of the subsidiary's employees were often determined by policies and directives of the parent.

Held: Award against CSR was upheld on appeal

- CSR was **held to owe a duty of care to employees of the subsidiary directly** and not on a secondary basis, by lifting the corporate veil
- Given that the whole of the management staff who had responsibility for the operational aspects of the subsidiary, and therefore the working conditions leading to the harm suffered, were CSR staff, **CSR had a duty directly to Mr Wren and that duty was co-extensive with that owed by an employer to an employee**
- Key factors:
 - Full board and management were employees of the parent
 - The working conditions were determined **according to the policies and directives of the parent**
 - The operation mauls were very similar, almost identical
 - In parent documents, sub is described as CSR's materials division

b. Under Statute

There are certain circumstances in which the corporate veil will be pierced according to statute. This is where:

- A parent is a shadow director of a subsidiary or other company (shadow directorship)
- A director may be liable for insolvent trading (s588G)

These instances are exposing directors NOT shareholders when the corporate veil is pierced.

The reason why learning whether someone is a de factor director or shadow director is important is because they might be liable for insolvency (a method of piercing the corporate veil).

Corporations Act (2001)	
s 9 - Definitions	<p>Section 9 (Definitions) defines a director as including:</p> <ul style="list-style-type: none"> • a person who: <ul style="list-style-type: none"> ○ (i) is appointed to the position of a director; (de jure directors) or ○ (ii) is appointed to the position of an alternate director and is acting in that capacity; regardless of the name that is given to their position; ("directors under another name") and • (b) unless the contrary intention appears, a person who is not validly appointed as a director if: <ul style="list-style-type: none"> ○ (i) they act in the position of a director; or (de facto director) ○ (ii) the directors of the company or body are accustomed to act in accordance with the person's instructions or wishes. (shadow director) <p>Section 9(b)(ii) can apply even if the firm does not own enough shares to be a holding company so that you may then become liable under s 588G even if s 588V does not apply.</p>
s 95A – Solvency and Insolvency	<p>(1) A person is solvent if, and only if, the person is able to pay all the person's debts, as when they become due and payable</p> <p>(2) A person who is not solvent is insolvent</p>
s 588G – Directors duty to prevent insolvent trading by company	<p>Imposes liability upon a person if:</p> <ul style="list-style-type: none"> • the person is a director of the company when the company incurs a debt; and • the company is insolvent when it incurs the debt or becomes insolvent because it incurs the debt; and • when it incurs the debt there are reasonable grounds for suspecting that the company is insolvent or would become insolvent because it incurs a debt; and • the director is aware at the time the debt is incurred that there are reasonable grounds for suspecting the company is insolvent or a reasonable person in a similar position in a company in the company's circumstances would be so aware • that time is at or after the commencement of this Act • Offence if failure to prevent company from incurring debt dishonestly else it is a civil penalty <p>NOTE: Parent company/another company (artificial legal person) can be directors of subsidiary company; Standard Chartered Bank of Australia</p> <p><u>Defences under s 588H:</u></p> <ul style="list-style-type: none"> • Reasonably thought firm was solvent • Told by someone (competent to do so that the firm was solvent) • Did not take part in management at that time due to illness • Took reasonable steps (i.e. appoint administrator)
s 588V – When holding company liable	<p>Imposes liability upon a holding company if:</p> <ul style="list-style-type: none"> • (a) Holdco was the holding('parent') company at the time when Subco incurs a debt; and • (b) Subco was insolvent at that time, or became insolvent by incurring that

	<p>debt...or debts including that debt; and</p> <ul style="list-style-type: none"> • (c) at that time, there were reasonable grounds for suspecting that Subco was insolvent, or would so become insolvent; and • (d) <ul style="list-style-type: none"> ○ (i) Holdco, or one or more of its directors, was or are aware at the time that there are such grounds for so suspecting; OR <ul style="list-style-type: none"> ▪ ‘suspicion’: more than mere idle wondering, a positive apprehension of opinion but fall short of positive expectation; Kitto J ○ (ii) having regard to the nature/extent of Holdco’s control over Subco, or any other relevant circumstances, it is reasonable to expect that a holding company in Holdco’s circumstances, or such a company’s directors, would have been aware of such grounds • (e) that time is at or after the commencement of this Act <p>NOTE:</p> <ul style="list-style-type: none"> • Must satisfy holding company subsidiary relationship; s 46 • This section is not a prohibition of insolvency. This section says you can’t borrow more money when you are insolvent.
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Shadow Director Cases:

- A shadow director is a person who exercises a controlling influence over the board of directors but is not appointed him/herself as a director
- The directors are accustomed to act in accordance with the person’s instructions or wishes - s 9
- The shadow’s influence must extend to the entire board — *Kuwait Asia Bank EC v National Mutual Life Nominees Ltd [1991]*

Standard Chartered Bank of Australia Ltd v Antico (1995)

Principle: Deals with Parent company: Shadow directorship requires both

- (i) a willingness and ability to exercise control, and
- (ii) actual control over the management and financial affairs of another company.

Facts:

- Pioneer a listed company owned 43% of the shares in Giant (another listed company). Three directors on Giant’s board were nominees of Pioneer. Bank was given security over shares that Giant owned but nothing else.
- Pioneer also provided loans but was ranked behind the other bank’s security.
 - In addition, it loaned funds to Giant on strict terms which gave Pioneer substantial control over Giant’s functions, imposed financial reporting functions on Giant and Pioneer ordered Giant to buy some of Pioneer’s assets. (**ROUTINE ADVICE TAKEN AND ACCEPTED, NO INDEPENDENT THOUGHT**)
- The subsidiary was wound up for insolvency and the Bank sued Pioneer and the 3 directors under s 588G.

Issue: Whether Pioneer was a director of Giant?

Held (Hodgson J):

- The court found that Pioneer was a shadow director of Giant
- This was found due to multiple reasons:
 - Pioneer had effective control (had the 42% and no other shareholder had any significant amount.
 - **Financial Reporting:** Imposed same requirements on Giant as themselves
 - **Acquisition of Pioneer’s mineral assets:** Pioneer authorised a committee to approve terms on which the asset sale could go ahead, Giant then resolved to acquire these assets. On discussion between the 3 Pioneer directors in Giant, they concluded with a recommendation not to proceed. However, this recommendation was given to Pioneer saying it was not in best interest of either company so they considered both Pioneer and Giant’s interests.
 - **Management and financial control:** P instructed Giant that all new financial commitments must be approved by Pioneer and that all payments were to be approached by Leach.
 - **Taking Security:** The decision to fund Giant was effectively made by Pioneer and simply accepted by Giant. This decision was never subject of careful consideration by the Giant board.
- To establish someone as shadow director/de facto director there needs to be **some effective control** (Substantial shareholding, financial reporting (access to record of company), management and financial control)
- **Must be routine advice, given and accepted + lack of independent will**

Yes, Pioneer showed a willingness and ability to exercise control, and an actuality of control, over the

management and financial affairs of Giant.

Buzzle Operations Pty Ltd v Apple Computer Australia [2011]

Principle: A secured creditor may be a shadow director if the debtor relies on its instructions simply because it is a secured creditor.

Facts:

- In July 2000, 6 retailers of Apple products merged to create Buzzle. Buzzle held much of its stock on credit from Apple and granted Apple a charge over its assets to secure its debt.
- By November 2000, Buzzle was insolvent but continued to trade, including making early debt repayments to Apple
- Apple had been heavily involved in the merger
 - It gave advice on the structure of the merger, future cash flow etc
 - Apple installed one of its senior finance officers in Buzzle's office
 - Buzzle's directors generally heeded Apple and its financial officer's advice
- In March 2011, Apple appointed receivers over Buzzle's assets. Buzzle went into liquidation.

Issues: Whether Apple and its financial director were shadow directors of Buzzle?

Held:

- A person is not a shadow director merely because they impose conditions on another company's commercial dealings, even if the company feels that it has no choice but to comply with those conditions
- Advice given in a non-professional capacity can amount to instructions or wishes, but not every person whose advice, instructions or wishes are heeded is a shadow director
- Key factors will be:
 - Causation
 - Majority of board habitually compliant
 - Instructions to directors in directorial capacity
- Young J
 - A secured creditor is not prima facie a shadow director unless the creditor's instructions were sufficient reason for the debtor's reliance. His Honour set out five propositions.
 - 1. A company can be a shadow director.
 - 2. A person is not a shadow director merely because the board follows his advice.
 - 3. Potentiality to control is important, but is not sufficient – **potentiality must be put into action. (Potentiality to control all the important aspects)**
 - 4. Where the board is split, shadow directorship can be established **so long as the influencer affects the decision-maker.**
 - 5. Do they exercise their power of control?
- Hodgson J:
 - Statutory formula contemplates that the director acts in accordance to wishes of a person in the sense of treating those instructions or wishes as themselves being sufficient reasons for the act as opposed to their own reasons' – **Fine to be giving suggestions on how they should act, but not fine to NOT submit that to an independent board.**

De Facto Director Cases:

- A de facto director is someone who works in the position of a director without being officially appointed as a director
- De-facto directors may, for example:
 - Not have been validly appointed initially as they failed to satisfy a prerequisite;
 - No longer validly hold office as a result of a supervening disqualification;
 - Have resigned as director, but not notified ASIC; or
 - Have assumed greater authority than that attaching to their office.

DCT v Austin (1998)

Facts:

- Mr Austin was appointed as a director of a company for 3 months. Mr Austin then sought to resign his directorship and his accountant prepared documents. These documents were never lodged with ASIC.
- Following his purported resignation, Mr Austin undertook numerous negotiations with the DCT for the payment of outstanding group tax and penalties, countersigned company cheques in favour of the DCT, issued stop notices to the company's bank and negotiated with other creditors

Held:

- The court found that Austin had performed important functions that were properly characterised as matters for management, such as negotiating with creditors and working with the company's accountant

It was not necessary to show that Austin performed duties that could only be performed by a director

Corporate Affairs Commission v Drysdale (1978)

Facts:

- Drysdale was appointed as a director of Command Minerals to fill a casual vacancy
- He continued to act as a director for a further two years, by attending board meetings, voting on resolutions with other directors, and participating generally in the management of the company
- Drysdale was prosecuted for breach of directors' duties. He argued that he was never a director.

Held:

- Drysdale was a de facto director, which therefore meant that he was bound by the statutory duties of company directors

De facto director — 'one who acts in the position of a director with or without lawful authority'

Grimaldi v Chameleon Mining NL (No.2) [2012] FCAFC

Principle: For de facto directors, as long as someone is acting in the position of the director they would probably be a de facto director.

Facts:

- Grimaldi was a director and controlling mind of Murchison Metals Ltd, who was sued by Chameleon for breach of fiduciary duties as an alleged de facto director of Chameleon
- Two transactions were at the centre of the controversy:
 - The acquisition by Chameleon negotiated for it by Mr Barnes (a director) and Grimaldi of gold mining tenements in consideration for an issue of its shares
 - A series of dealings including a loan and a planned reverse takeover which included a spotters fee in the form of shares

Held: G is was the defacto direction, caught under expanded definition in s9

[62] –[76] and [130] –[135] The definition of director in s 9 applies as much to a person who is a true usurper of the functions of a director in a company as to a person who takes 'an active part in directing the affairs of [a] company' with the acquiescence of de jure directors.

- **Meaning:** As long as the person concerned, though not appointed a director, has been 'doing the work of a director' in that company and performing functions one would reasonably expect to have been performed by a director of that company given its circumstances is seen as a director under s 9.

It has commonly been said in both Australian and English cases (though it has been disputed by Madgwick J in Austin, at 569) that to be a de facto director one must be shown to have assumed or performed functions which only a de jure director or board can properly perform.

Three other points need to be considered:

- The company has an active director apart from the alleged de facto director.
- Whether the company itself has held the person out as a director will itself be relevant but not decisive consideration.
- Also we need for other purposes to make some reference to the position of a secretary of a company and its functions and it is convenient to do so here.
- Look at the other directors and see how they act.

Here the facts:

- Grimaldi was only allowed to attend board meetings with invitation and they did not regard him as a director.
- However, they clearly authorised him on occasion to perform functions such as would lead a reasonable third party dealing with him to believe he was acting as a director of Chameleon. (Authorisation to negotiate the acquisitions of Fijian Mining)
- Court: We do not consider that giving of prior authorisation to act for Chameleon or the need for subsequent board action to effectuate what he has done, changed the character of what he was allowed to do in circumstances where what he did was what a person acting in the position of a director would be expected to do.

BCI Finances Pty Ltd v Binetter [2016]

Michael Binetter's "de facto" or "shadow" directorships

239 In summary, the liquidators contended that Michael Binetter was a de facto or shadow director of each of the applicants, except to the extent that he held a valid appointment as a director.

240 By s 9(b) of the Corporations Act, a director means relevantly, a person who is not validly appointed as a director if:

- (i) they act in the position of a director [a de facto director]; or
- (ii) the directors of the company are accustomed to act in accordance with the person's instructions or wishes [a shadow director].

241 The court applies an objective test in determining whether a person is a de facto director: *Smithton Ltd v Naggar* [2014] EWCA Civ 939; [2015] 1 W.L.R. 189 at [39]. A person may still be a de facto director even if the company concerned has a properly constituted and functioning board: *Grimaldi v Chameleon Mining NL* [2012] FCAFC 6; (2012) 200 FCR 296 ("*Grimaldi*") at [74] and [132] to [134]. Whether a company has held out a person as a director is a relevant consideration: *Grimaldi* at [75].

242 The liquidators submitted that it is necessary to consider the functions that would be expected to be performed by a director of the relevant company in the circumstances, the functions carried out by the alleged “de facto” director and whether the person was held out as a director by the company. The role and functions performed by a director will vary with the commercial context, operations and governance structure of the relevant company. The functions assumed need not relate to all facets of the management of the company’s business: *Grimaldi* at [65] to [69].

243 A person may alternatively, or also, be a “shadow” director. Generally, being “accustomed to act” in accordance with the wishes of a person involves “habitual compliance over a period of time”: *Buzzle Operations Pty Ltd (In Liq) v Apple Computer Australia Pty Ltd* [2010] NSWSC 233; (2010) 77 ACSR 410 (“*Buzzle*”) at [248]. Although the directors collectively must be accustomed to act on the person’s instructions or wishes, it is sufficient if a governing majority is so accustomed: *Buzzle* at [250]. The instructions of the shadow director need not be given in relation to the whole of the corporation’s activities for which directors are responsible: *Buzzle* at [241].

244 *Ford’s Principles of Corporations Law* summarises the following factors which are considered by courts in deciding whether a person is a de facto director:

- (1) the duties that would be expected to be performed by a director in the relevant company – noting that this will vary according to matters such as the size of the company and the allocation of the responsibilities within the company. This is subject to the requirement that the person performs what the court in *Deputy Commissioner of Taxation v Austin* [1998] FCA 1034; (1998) 28 ACSR 565 referred to as “top-level management functions”;
- (2) the duties actually performed by the person;
- (3) whether others in the company considered the person a director;
- (4) whether the company held out the person as a director;
- (5) whether the person held themselves out as a director; and
- (6) whether those outside the company considered the person to be a director.

245 The businesses of the applicants are identified earlier in these reasons. Except for Ligon 268 (which was also trustee of the Bankstown Eye Trust), the businesses comprised procuring and on-lending funds to related companies. In that context, the role of the directors was primarily concerned with procuring funds from the Israeli banks to support the business activities of associated entities in Australia, in a way that involved minimal tax liabilities. For those directors who had agreed to participate in or facilitate the scheme, their roles included:

- (1) procuring the “back-to-back” arrangements by which offshore funds were used as security for advances of funds by the Israeli banks to the various applicants;
- (2) documenting the arrangements so as to permit the applicants to produce documents purportedly evidencing the arrangements but which did not disclose the offshore deposits;
- (3) causing or procuring the lodgement of income tax returns on behalf of the relevant applicant which would declare no or no significant taxable income referable to the transactions that occurred as a consequence of the “back-to-back” arrangements.

246 After the revised assessments were issued, the role of the directors of each of the applicants included managing the subsequent tax disputes.

Conclusion:

B was not shadow director but defacto director. Based on the evidence of his participation in the tax disputes between the applicants and the ATO, identified below, I infer that Michael Binetter was a de facto director of each of the applicant companies after the commencement of the ATO tax audit. In that role, he caused or procured the lodgement of several income tax returns by the applicants pursuant to the scheme.

c. The Position of Employees Upon Insolvency

Corporations Act (2001) Part 5.8A

s 596 AA	<p>The object of this part is to protect the entitlements of a company’s employees from agreements and transactions that are entered into with the intention of defeating the recovery of those entitlements.</p> <p>Entitlements include:</p> <ul style="list-style-type: none"> • (a) Wages; • (b) Super contributions; • (c) Compensation for injury; • (d) Holiday pay; and
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	<ul style="list-style-type: none"> • (e) Retrenchment payments for the employee
s 596 AB	<p>A person must not enter an agreement or transaction with the intention of:</p> <ul style="list-style-type: none"> • (a) preventing recovery of employee entitlements; or • (b) significantly reducing the amount of the entitlements of employees of a company that can be recovered.
<p>Section 596AC allows for compensation from loss.</p> <p>Problems:</p> <ul style="list-style-type: none"> • Note, however, it is difficult to prove the employer's subjective intentions at a criminal standard, and thus, this may not be an effective provision to protect employee entitlements. • Employee entitlements would not cover tortious activities. • Very broad – 'a person', 'significantly reducing' – ambiguous • How would we identify the conduct? Insolvency usually occurs from a number of conducts and done a group of people. • Can be justified from a number of motives. 	

CORPORATE CONSTITUTION

1. WHAT IS A CORPORATE CONSTITUTION?

a. Historical Background

Historically, prior to the Company Law Review Act 1998, there were two distinct corporate constitutional documents, generally bound together in a single document:

- **Memorandum of association:** This was the incorporating document, which contained fundamental matters such as the company's capital structure. (**Governs relationship between company and outside world**)
 - Mandatory
 - (Needs objects clause – Sets out company purpose and anything outside the purpose was ultra vires.)
 - This was removed later since lawyers made it extremely broad and allowed them to do anything.
- **Articles of association:** These usually detailed provisions relating to the **internal organisation of the company**, for example, the division of powers between board of directors and shareholders in GM, appointment and remuneration of directors, transfer and transmission of shares etc.

Historical company legislation provided for a model set of articles called **Table A articles (default rules)** which could be adopted outright, or adopted with variations, or not adopted at all.

- **Table A rules only applies at the time when you incorporated** so any changes in the rules would not apply.
- **Table A got changed into replaceable rules (Company can choose to have these rules). But each time the legislature amends it, it automatically applies.**

From 1844, in the UK, all registered companies were required to lodge their memorandum and articles with a state official so they were publicly accessible. In Australia, this obligation only applied to public companies from the early 1990s.

On 1st July 1998, the requirement to have a corporate constitution was abolished.

- Post 1st July 1998 — replaceable rules; constitution; or combination of both — s 134
- Pre 1st July 1998 — memorandum of association and articles of association
- If a company adopts its own constitution, this will displace the application of any inconsistent replaceable rules, except a rule which is expressed to be mandatory and which operates therefore as an ordinary provision of the Act

b. Contents of the Corporate Constitution

The Companies Law Review Act 1998 introduced a series of provisions, which any company may use to regulate its internal proceedings and management in place of a memorandum and articles. These provisions are known as 'replaceable' (or in some cases 'mandatory', at least for public companies) rules.

(1) Essentially, companies can do one of three things under s 134:

- **Operate without constitutional documents, thus relying solely on replaceable rules.**
- **Adopt its own constitution to displace or modify the replaceable rules wholly or in part: s 136**
- **If it already had a constitution pre-1998 (ie most companies), it could continue to operate according to its constitution to the exclusion of inconsistent replaceable rules.**

The **replaceable rules do not apply** to a proprietary company with a single shareholder/director: **s 198E.**

The list of replaceable rules: s 141

Section 141 helpfully sets out **all** of the replaceable rules provided for in the Act:

(2) Non-compliance of any replaceable rules **DOES NOT GIVE RISE TO BREACH (ONLY INJUNCTIONS)**

Corporations Act (2001)	
s 117	Sets out requirements for establishing a company