

TOPIC 1: INTRODUCTION – Types of Companies

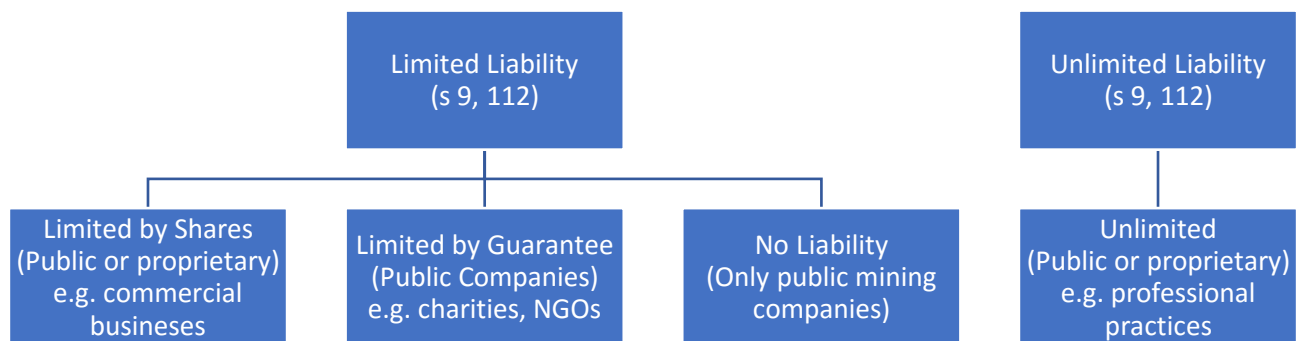
‘Companies’ formed by registration under the Corporations Act as either public or proprietary companies; s 9

A company is EITHER a proprietary or a public company

	Proprietary (Pty Ltd)	Public (Ltd)
Shareholders s 45A(1); s 113	Minimum 1 shareholder Maximum 50 non-employee shareholder	Minimum 1 shareholder No maximum
Members s 114	Minimum 1 member	Minimum 1 member No maximum
Directors s 201A	Minimum 1 director (resident)	Minimum 3 directors (2 resident) + 1 company secretary
Finance s 45A(1); s 113	Cannot obtain funds from the public	Can obtain funds from public (w/disclosure document)
Listing s 45A(1); s 113	Cannot be listed	Can be listed or unlisted BUT not all public companies can be listed on the stock exchange (ASX)
Type s 45A(1); s 112	Limited by shares Unlimited with share capital	Limited by shares Limited by Guarantee Unlimited with share capital No Liability Company
Registration	ASIC	Unlisted – ASIC, APRA Listed – ASIC, ASX, APRA

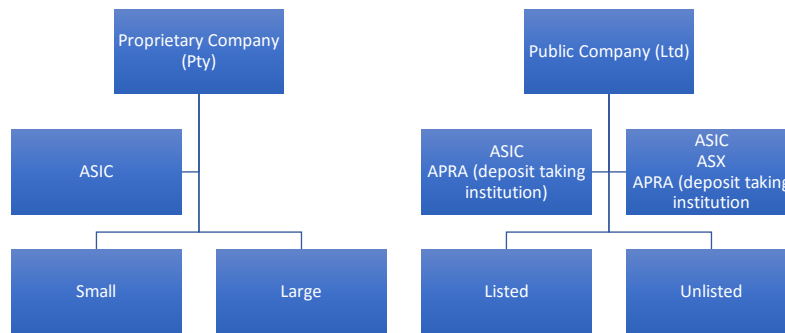
- A public company, which adopts a constitution MUST lodge a copy with ASIC together with a copy of any special resolutions altering its provisions (ss 117(3), 136(5)). It is then publicly available.
- A proprietary company, which adopts a constitution, need not lodge with ASIC but must send a copy to a member of the company upon request (s 139)

Liability



- **Limited by Shares:** company formed on the principle of having the liability of its members limited to the amount (if any) unpaid on the shares respectively held by them.
 - If shares are fully paid, their holder has no further obligation to contribute to the debts and liabilities of the company, at least in relation to those shares.
- **Limited by Guarantee:** company 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 of the company if it is wound up → no shares issued (no share capital)
 - Since member's guarantee may only be enforced on the winding up of the company, they are NOT assets of the company, which may be charged during its life.
 - Annual revenue > 1 mil → must prepare an audited financial report; 250K – 1 mil → must prepare financial report (audit optional), <250K → not required to prepare report
- **Unlimited:** company whose members have no limit placed on their liability to contribute to debts of the company → only when company's assets exhausted liability on shareholders
- **No Liability:** Members are not liable to pay any calls on their shares.
 - **s 112:** must have share capital, constitution states sole objects are mining purposes + no K rights under CC to recover calls made on its share from a shareholder who fails to pay them
 - **s 148(4):** has NL as part of the name/end of the name

Size + Listing



Proprietary Companies (Either Limited by Shares or Unlimited)

Privileges of all proprietary companies:

- Can register with a single shareholder and trade with a single director (ss 114(1), 221(1))
- No requirement to hold AGM (s 250N)
- Resolutions required or permitted to be passed at FM may be deemed to have been so passed even though no meeting (s 249A)
- There is no need for each director to be appointed by a separate resolution when the appointment is by the company in GM (s 201E)
- Directors may be made removable by other directors, if power to do so is given in the constitution (s 203E)
- The regulation of financial benefits to directors and other related entities in Ch 2E do not apply
(**Directors can participate in decision making even with personal interest**)

All companies **must keep written financial records** that correctly record and explain their transactions and financial position to be **prepared and audited (s 286)**

<u>Small</u>	<u>Large</u>
<p>To be a small proprietary company for a financial year, it must satisfy at least 2/3 criterion:</p> <ul style="list-style-type: none"> • Consolidate gross income is less than \$25m • Assets is less than \$12.5m • Total number of employees is less than 50. <p>Small Companies do not have to:</p> <ol style="list-style-type: none"> 1. Have their accounts audited 2. Lodge their accounts with ASIC; ss 295, 292(2) <p>Obligations to audit and publish results may arise if:</p> <ul style="list-style-type: none"> • Shareholders with at least 5% of votes direct the company to do so (s 293) • Company is controlled by a foreign company and is not included in consolidated accounts lodged with ASIC by the foreign company (s 292) or • ASIC directs it to do so (s 294) <p>ASIC may relieve a company from financial reporting and audit obligations, including those arising by virtue of shareholder direction, by reference to criteria including whether these obligations would impose unreasonable burdens on the company (s 342).</p>	<ul style="list-style-type: none"> • Must also prepare financial statements for each financial year, have those statements audited and lodge them with ASIC so that they are publicly accessible (s 295).

TOPIC 2: CORPORATE PERSONALITY

1. 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.

s 124	<ul style="list-style-type: none"> • 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	<ul style="list-style-type: none"> • 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. • 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 <ul style="list-style-type: none"> ○ Rather it is a breach of the constitutional contract (injunction can be sought)

2. Corporate Personality vs Limited Liability

- Corporate Personality; **s 124** vs Limited liability; **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.
- **Limited Liability**
 - Limited liability came in the 19th century with the Limited Liability Act 1855 (UK). (LLA)
 - Corporate personality serves the function of marking out an asset pool against which creditors of the enterprise have prior claims → partitions 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
 - 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

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 • By im personalising 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]

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.

TJ: Agency

Company is agent of S – S therefore liable, debentures issued to S + transfer of business invalid due to fraud

COA: Trustee

- S is trustee of company therefore S must indemnify company (beneficiary) i.e. pay creditors
- S abused privileges of incorporation and limited liability provided by the Company's Acts
- Only to 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 → 'bona fide' not in legislation

HOL: 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.
- **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]

- L established company, controlling shareholder + governing director + employee pilot → died, wife sought compensation under a worker's compensation insurance policy
- Relevant time of death → piloting company aeroplane → paid wages and these were recorded in the company's books
- **A person can operate in a dual capacity in a company. Company is separate even from controllers.**
 - 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 employment contract b/w company (separate legal capacity) and L (personal legal capacity). L as director acting as the company hires L in his personal capacity as a pilot

3. Piercing the Corporate Veil

- 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*
- **Corporate Veil – s 124**

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

a. Common Law

Fraud/Improper Conduct

- The whole purpose/intention of incorporation by its controllers is an attempt to **avoid an existing legal duty** that otherwise falls on the controller personally.

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

- H had restrictive non-compete clause in employment K → at termination of K, H set up company competing against GM, H was effectively manager + controller
- H purposely incorporated to avoid the restrictive non-compete (sole purpose) → justifies lifting corporate veil

<ul style="list-style-type: none"> ○ '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 covenant' ○ 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. • Distinguishing features to <i>Salomon Case</i> <ul style="list-style-type: none"> ○ 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 <i>Garbutt Business College</i> (identical facts) <ul style="list-style-type: none"> ○ Injunction can be awarded: <ul style="list-style-type: none"> ▪ 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 <ul style="list-style-type: none"> • 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.
<p>Jones v Lipman [1962] 1 ALL ER 442 (English HC, Chancery Division)</p> <ul style="list-style-type: none"> • L entered into K with J for sale of house → before finalised L did not want to sell house to J, rather sold to company (directors included L and clerk) for a lower price. J seeks specific performance. • Followed <i>Gilford Motor v Horne</i> → Specific performance awarded • 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. • The court described the company as: <ul style="list-style-type: none"> ○ 'A device, a sham, a mask which he holds before his face in an attempt to avoid recognition by the eye of equity.'
<p>Fair Work Ombudsman v Ramsey Food Processing [2011]</p> <ul style="list-style-type: none"> • R group of companies set up to run abattoir; R→guiding mind, RFP→operated abattoir, TH supplied staff to RG. TH terminated employment for all staff, owed substantial money to employees, FWO sues • Court held that R was the true employer and liable to pay the outstanding employee entitlements • The finding was based on the fact that TH was completely reliant upon R <ul style="list-style-type: none"> ○ No assets ○ No management structure ○ Did not operate as an independent business • TH was a corporate shell to protect Ramsey Food from liability from employees
<p>Prest v Petrodel Resources Ltd [2013]</p> <ul style="list-style-type: none"> • Distinguished between the concealment principle and the evasion principle <ul style="list-style-type: none"> ○ Concealment Principle: NOT piercing corporate veil, occurs when interposition of a company or perhaps several companies so as to conceal the identity of the real actors → does not deter the courts from identifying them assuming that their identity is legally relevant. ○ Evasion Principle: piercing corporate veil → 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. <ul style="list-style-type: none"> ▪ Pierce the corporate veil 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

Agency

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

Facts:

- SSK bought out paper manufacturing business (sub):
 - 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
- Sub operated on SSK land, BC purchased land for public works, SSK applied for compensation for cost of relocating
- Compulsory acquisition laws provided that tenants without a long-term lease were not eligible for compensation → sub only had short term lease → who sues?

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 (note: highly criticised)
 - 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.
- Comparison wrt *Salomon*: → however *Salomon* rules not agent
 - Veil piercing to get to an individual → perhaps not as critical in a corporate group setup
 - Agency relationship is more likely to be established where a benefit is being conferred → not creditor seeking money from SSK
- Perhaps another point for list: 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
- 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.

Re FG Films [1953]

- FGI (US) had the rights to produce a movie → wanted to receive a subsidy offered in UK → created/incorporated UK company, FG (owned 90% of shares) who would technically produce the movie, although all funding and other aspects were done by FGI and the movie was to be produced in India. The licensing authority refused on ground that it was not made by FG.
- FG agent of FGI → therefore no subsidy
 - 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.
- FG's participation in the undertaking of the film was so small as to be practically negligible and they acted merely as the agent for FGI. The sole purpose of making the entity was to satisfy the requirement of the statute.
- Thus, the corporate veil was lifted because court looked into actual shareholders and not just the company as registered in England.
- **Critique:** This case could arguably fit in under the fraud/improper conduct category studied earlier

Corporate Groups

- **Corporate group** — 'a number of companies which are associated by common or interlocking shareholdings, allied to unified control or capacity to control'
 - Group can be a family of subsidiary companies (s 46) under a holding (parent) company which has majority ownership or voting control of the subsidiary companies **OR**
 - 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?