

# Corporate Law Notes

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*Facts:*

*Issues:*

*Decision:*

*Significance:*

# Topic 1: Contextual, Ethical and Theoretical Issues

## Theory and Corporate Law Podcast

### Why Theory?

- Theory of corporations pose fundamental questions – these below three points are to be considered.
- Consider what a corporation is.
- Consider what the purpose of a corporation is.
- Consider how corporations should be regulated.

### What is a Corporation?

- Public v Private Relationships
- Is a corporation anything more than the exploitation of private property rights?
  - See s 1070A.
  - The provision provides what a share is – viewed as private property. Recognition that shareholders have private property which consists of the shares that they hold in the corporation.
- Contrast classical ‘regulated corporations’ set up for public purposes by royal charter or private legislation with private business companies (eg, joint stock companies, and companies registered under general incorporation legislation).
- A corporation is a set of private relationship between property owners and the managers of that property on the other.
- It is totally or in part within the public domain.
- Some theories view it as a political/social institution.
- Something that is fundamentally private in nature; private property owners; who they choose to manage that property (i.e. shareholders (money)/executive managers/board of directors (responsibility to manage property for the benefit of the shareholders); corporation as a public institution (i.e. UTS is a corporation).
- Corporations are not just an exercise of property rights. They provide the greater majority of our essential goods and services in our lives. Corporations are everywhere. Hence, they are public in nature conveying the political/social distinction.
- Not logical nowadays to have the public/private divide. Government provides services through companies. Governments engage in commercial activities and make a profit (i.e. Sydney Water).
- Modern corporate law: general powers of incorporation; anyone can set one up nowadays; historically it was difficult done by virtue of a private statute.
- The structure of corporate law in Australia is set up to protect the interests of those private shareholders.
- The law: ‘Once a company has been legally incorporated it must be treated like any other independent person with rights and liabilities appropriate to itself’: *Salomon v A Salomon & Co Ltd*.

## Theories of the Corporation

### *Is it a real thing or not?*

Yes

- Managerialist (growth of conglomerates which used internal capital and product markets).
  - The corporation as a hierarchy of management.
  - A large proportion of large public companies in US had no shareholder with a controlling stake. Poses challenges of how we view control of private property.
  - A corporation can be viewed as a managerial hierarchy. Managers going up the chain. Focus of this approach is on the actual managers of the corp itself.
  - A push for fiduciary obligations. There is a presumption that managers may do things that they are not engaged to do – legal system to increase profitability for the corporation → flow on effects that positively benefit society, shareholders and creditors.
- Concession theory (created by state authorisation).
  - Based on view that corps are a real thing, but are only a real thing because there is a statute that says the corporation exists.
  - Based on the significance of the legal recognition of the corporation
  - . A benefit given out by govt and that benefit is a privilege (and thus comes with responsibilities). Thus, justifies regulation of corps.
  - Not as relevant nowadays, anyone can really start of a corporation.
- Aggregate /natural entity (more than the sum of its shareholders).
  - A corporation is a real thing, and the legal recognition is just a provision of certain legal rights.
  - Corporation would exist even without general right of incorporation.
  - Corporations are the natural effect of the conglomerate of individuals. People come together to do things (i.e. run businesses). Further, then those businesses begin to make a life of its own, even in the absence of legal recognition. I.e. this can be seen through unincorporated associations.
- Communitarian (company as a social institution).
  - View that corporations are a social entity.
  - We need to look at the different stakeholders, stakeholders that interact with corporation and the broader community.
  - What role do corporations have in the community? Often used as a contrast from the economic perspectives.
- Political institution (company as an expression of social power).
  - Just as we regulate political parties, we should regulate corporations.
  - A corporation has an important role in society (conglomerate of people coming together), and there is a responsibility to regulate the contribution and how it interacts with society – thus it is a real thing.
- Feminist (company as a social institution founded on gender bias, inequality, exploitation of property rights and conflict).
  - See the corporations as a social institution; focus on how relationships develop and interact within and with the corporation.
  - Assess how corporations affect workers and their families, affect on power dynamics in society, and focus on the role of woman in corps from the perspective of property ownership.

- A feminist critique: ignore non-property rights holders; reinforces pre-existing power inequalities in society (as woman historically have no owned property).
- Another critique: Corporate law focuses too much on addressing conflict, rather than connections and relationship within which corps and stakeholders interact with each other. Property managers will act selfishness.
- Critique: focus on a largely male paradigm of conflict and selfishness, rather than connection.

## No

- Contractarian (economic)-a corporation is a nexus of contracts.
  - Relationship between capital providers and the managers of that capital. Without capital, then the corporation cannot operate.
  - Marketplace where providers of capital and users of capital interact with one another.
  - Corporation law is about managing agency cost. Agency cost is when the owners of property appointing agents to manage that property.
  - We don't regulate the corporation; we regulate the people who work within the corporation and those that interact with it. Thus, the role of law is to try and make the contracting process more efficient.
  - Under contractarian perspective, negative externalities are largely ignored. If people get hurt, it is not the point of corporate law/contract law to address it.
  - Consider Coase theory of the firm (firms arise when the cost of producing goods and services is cheaper than obtaining these through markets).
    - Coase theory of the firm: trace back to economics research papers.
    - Outsourcing v In-house decisions.
- Team production model (TPM)-corporation as a mediating hierarchy that is designed to lock capital into the enterprise.
  - Managers of corporations may have a tendency to get perks for themselves rather than benefit the shareholders.
  - Attempts to constrain agency costs by making it harder and more expensive to do so. Not a real thing; but it is not simply a marketplace. Rather it is a mediating hierarchy that is development to manage the providers of capital.
  - Directors are the mediating hierarchy that has to make decisions about how the output of the corporation is shared between the team members.
  - Role of directors is to how to allocate what the corporation produces (e.g. creditors must have to have a good return, so they withdraw their loans, etc).

## What is the Purpose of Corporate Law?

- Should corporate law be used to address bargaining and wealth inequalities?
- Shareholder primacy revisited (eg TPM).
  - Are shareholders really the residual risk bearers?
  - Communitarian v economic perspectives
- Mixed goals:
  - Investor protection
  - Managing agency costs
  - Reducing transaction costs (including the competition for capital)

- Efficiency v equity
- Feminist critique-corporate law entrenches conflict, separation and existing hierarchy, individuals valued over groups, economic gains valued over other benefits.
- Alternative foundations: trust, legitimate expectations and mutual responsibilities, the corporation as custodian.
- Corporate law is about protecting capital providers. Other theories beg to differ.
- Other theories hold that it is not ok for corporations to rip off employees; make products that hurt people. Corporations law should look after this responsibilities.
- Shareholder primacy: economics: if nothing more than a nexus of contracts, how should corporate law look after that? Greater efficiency.
- Main aim of corporate law is to maximise shareholder wealth – primacy norm. This should be the guiding norm of corporate law. Shareholders have to pay its obligations. Only after creditors are paid, then it has a surplus to return to shareholders (i.e. by dividends, buying back shares and putting it back in the business). Everyone else must get paid before the shareholders do. Communitarians say that harm is being dealt on community and employees so company can make a profit.
- If a company goes bust, shareholders lose their money. But employees also lose their jobs. Customers lose their products. Suppliers lose a customer. Community loses tax revenue source. There are many stakeholders affected by corporate failure.
- We must look at the rules from a variety of perspectives in order to get the optimal view. This is what the corporations act attempts to do.
- Not one single theory will provide what corporate law actually is.

## Companies in Context Podcast

### Rationale for Forming Companies

- Why do people form companies?
  - A means of limiting the liability (i.e. managing risk) of members (shareholders).
  - Enables investment and business growth → economic growth.
  - Enables perpetual succession.
- Companies (corporations) have separate legal personality.
  - Meaning they may enter into contracts;
  - may employ people;
  - may raise capital;
  - may borrow, lend and invest capital;
  - and may sue and be sued.

### Stakeholders of Companies: someone who has an interest in a company

- **Shareholders (members):** invest capital into companies → receive shares (securities) in company → meaning they have equity in company (right to share in net worth of company or to receive dividends which is a distribution of the company's profits)
  - Retail – individual investors
  - Institutional investors – banks, insurance companies, superannuation funds, governments, fund managers



- Companies would like a good mix of debt and equity (in order to get tax advantages).
  - May sell their shares; may receive dividends (distribution of company profits).
  - They've got equity in the company.
  - Shareholders may be categorised as:
    - Retail – individual investors; and
    - Institutional – banks, insurance companies, superannuation funds, governments and fund managers.
- **Directors:** govern companies (involved in management)
  - In small (closely held) companies, directors often involved in management.
  - In larger companies, directors delegate management to managers & employees.
- **Creditors:** lend capital to companies. Can include financial institutions, companies and individuals (contractual promise for the latter two) → contractual promise to receive their lend with interest on top
- Can also include:
  - Contractors and business partners;
    - See also mergers and acquisitions.
    - Business is a big web of contracts.
  - Employees;
    - Director duties generally don't attach to employees.
  - Interest groups;
  - Community groups;
- There is an increasing prevalence of Corporate Social Responsibility (CSR).
  - Companies behave and conduct business in a socially responsible way.
- Corporate law theories seek to explain how corporate law should balance all these interests (see above).

### Key Roles in Companies

- Directors may be:
  - Executive: employment contract with company; or
  - Non-executive: no employment contract with company – only association through role as director.
- Board of Directors – Chair of board (person in charge) – generally head of company.
- CEO/Managing director – in charge of management – can sit on the board and report to the board overall.
- Chief Financial Officer (CFO) – report directly to CEO and have a relationship w/ board.
- **Company secretary** (Chief Administrative Officer)– person who keeps all administrative aspects all organised. Also known as Chief Administrative Officer of the company.
  - Filings, meetings of directors, administrative aspects of the company in check
- For larger companies: in-house/corporate counsel – usually headed by a “**General Counsel**”.
  - Bring legal skills and aspects to the business
- CS and GC are often combined.
  - CS often has a number of assistances that are either internal or outsourced

### Internal Rules of Companies

- Company constitution – sets out the rules for the governance of the company – which may include:
  - Issue and transfer shares;
  - Powers of directors;
  - Meetings of directors and members; and
  - Changes to company structure and activities.
- Has the effect of an enforceable contract between company and its members.
  - Under the Corporations Act, it acts as a contract. Any breach of contract can be brought to court.
- Pre-1998: memorandum of association and articles of association (constitution).

### Types of Companies

- Companies (around 2 million in Australia).
  - Public (Ltd)
    - Listed (around 2,000 listed on ASX).
    - Unlisted.
    - Can raise funds; advertise securities to gain money from.
    - Only public companies can legally list on the ASX.
  - Private (Pty Ltd).
    - Small or large: s 45A of the Corporations Act.
    - Can't raise capital for the members of the public
- Corporate groups: parent (holding) company and subsidiary companies.
- Other business structures: sole trader, partnership, joint ventures, associations and trusts.

### Corporate "Life Cycle"

- Incorporation – comes into existence. Must be registered with ASIC; form a constitution.
- Operation
- Possibly – change of structure – e.g. if company grows/need to raise more funds.
- Possibly – if company encounters financial difficulties – external administration → winding up (may be prompted by members, by creditors, or by ASIC).
  - Obligations shift to satisfying needs of the creditors.
  - Can go into external administration – insolvency firm – look at concepts or voluntary receivership and liquidation.
  - Whatever is left after winding up may be returned to members.
- De-registration by ASIC.
- Individuals can become personally bankrupt but the company can become insolvent

### Corporate Fundraising

- Securities/stock/capital markets – financial market jargon.
- Australian Securities Exchange – see [www.asx.com.au](http://www.asx.com.au) - electronic market.
- Enable larger companies to be listed (floated) – raise funds from public.
- The company's securities may then be bought/sold (traded) on market.
- Enhanced requirements: disclosure of information to investors.

### Regulation of Australian Companies

- Until 1980s – States/territories regulated companies.

- Transfer of regulatory powers to Commonwealth.
- Australia Securities and Investment Commission (ASIC) deal with the following:
  - Regulator of consumer credit and companies.
  - Maintains a public register of companies → information for investors, creditors, contractors, etc.;
  - Companies over specified sizes must lodge financial reports;
  - Investigation – fraud; breaches of *Corporations Act*; and
  - Enforcement – criminal, civil or administrative remedies.

### Themes in Corporate Law

- Involves both legislation (*Corporations Act 2001* (Cth)) and common law.
- Some themes examined in this course:
  - Protecting rights of members – disclosure of information; participation in meetings; and approval of decisions.
  - Ensuring directors act in company's best interests → conflicts of interest, good faith, proper purpose, duty of care and diligence.
  - Safeguarding rights of creditors.
    - Insolvency: inability to meet long-term financial obligations.
  - Remedies for breaches.

### Harris Textbook Notes

#### Corporate Law: Theories, Principles and Applications – Chapter 1

#### *Corporations and Companies*

##### Identifying the Nature of our Subject

- A 'company' is defined in the Dictionary in s 9 of the *Corporations Act* as being 'a company registered under this Act', which narrows the scope of the term to very specific entities and does not include other business entities with corporate-like features, such as incorporated associations, co-operatives or foreign companies: see also *Re Featherston Resources Ltd*.
- A 'corporation' is defined under s 57A to include a company in addition to any body corporate (in Australia or overseas) and an unincorporated body that has the features of separate legal status under the law of its place of origin.

##### Types of Companies

- Section 112 provides for public companies and proprietary companies, each of which may have either a limited or unlimited capital structure.
- Companies limited by guarantee do not issue shares and therefore have no share capital. Rather guarantee is drawn from each member's guarantee: s 517.

##### Different Corporations

- Refer to p 4 for the difference between corporations sole and aggregate.

##### The Key Elements of a Corporation

- Board of directors is most important decision-making organ of corporation: s 198A.
- Members who make decisions by passing resolutions in general meetings are an important element of the corporation.
- The balance of power between the board and the members in a general meeting as decision-making organs is set out in the company's constitution and the Act.