

CORPORATE LAW

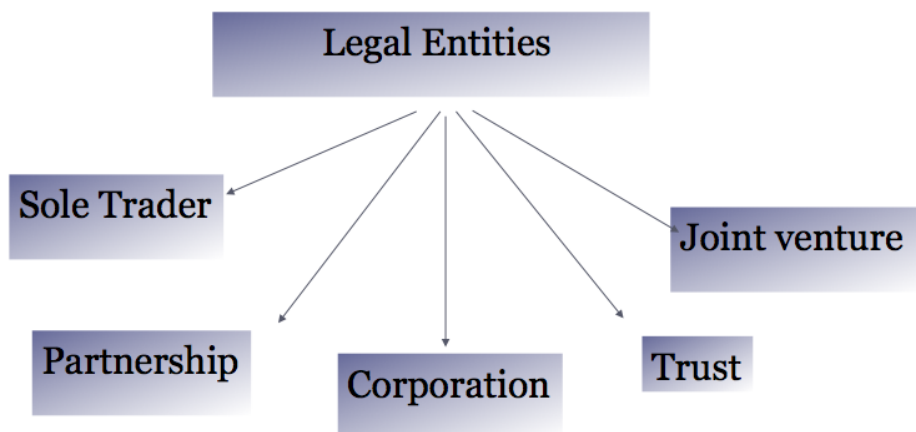
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INTRODUCTION

How should you organise a business?



- Partnerships are not a separate legal entity – a partnership does not allow for investors
- A corporate is another legal person – has legal capacity – registration process creates a legal person – separate legal entity upon incorporation which includes all powers of a natural person – entity is separate from its members, controllers, investors, directors etc.

What is looked at in this unit?

- What happens before the corporation is formed?
- Start of the corporation – incorporation and the veil of incorporation
- The rules of the corporation – The corporate constitution and replaceable rules
- The internal management of the corporation and the manner in which the corporation can deal with outsiders
- The responsibilities of those managing the corporation – corporate governance / directors duties
- Issues around funding
- The way in which corporations are wound up

- Internal management rules (found in Company Constitution or Replaceable Rules in *Corps Act*) – rules regarding how the separate legal entity is governed and how the relationships between the entity and other players are governed
- Internal players = company agents (directors)
- External players = shareholders, creditors, other companies, employees
- Two ways that a corporation, as a separate legal entity, can get funding:
 - Can sell shares in itself (selling part of its ownership) – equity funding
 - Can borrow (loans) – debt funding

What is a company?

- 'A legal device by which legal rights, powers, privileges, immunities, duties, liabilities and disabilities may be attributed to a fictional entity equated for many purposes to a natural person' (Ford)
- 'An association of a number of persons with a common object or objects; the term usually denotes a business or professional association' (Encyclopaedic Australian Legal Dictionary)
- 'A number of persons united or incorporated for joint action, especially for business' (Macquarie dictionary)
- 'Company means a company registered under this Act' (s 9 *Corporations Act 2001*; s 57A defines 'corporation')

Advantages of adopting a corporation/company form:

- Separate legal entity
- It can own property and borrow money
- Owners (shareholders) usually have limited liability – increases the ability to raise funds
- Certain tax advantages
- Means by which investment can be generated

Disadvantages of a corporation/company:

- Complexity (depending on size)
- Minority owners may have little input on how the company can run
- Subject to reporting requirements – on the ASX

CONTEXT OF AUSTRALIAN CORPORATIONS

Origins of English company law:

- In medieval times, companies could not be formed under general law but were incorporated by consent of the monarch under Royal Charter (e.g. trade guilds, local authorities)
- Evolution of trading companies (e.g. East India Company incorporated by Royal Charter or special statute)
- By end of 17th century evolution of joint stock companies (undertaking divided into shares) from partnerships to undertaking large scale commercial ventures
- Enactment of general companies legislation to provide for registration of a company upon application to Registrar of Companies (*Companies Act 1844* Eng) and introduction of limited liability for shareholders (*Companies Act 1855* Eng)

Origins of Australian company law:

- Pre-federation – legislation of Australia's colonies modelled on English legislation – adopted *Companies Act 1844* (Eng) & *Companies Act 1855* (Eng)
- Corporations Power:
 - Section 51(xx) of Commonwealth Constitution conferred power 'with respect to foreign corporations and trading and financial corporations formed within the limits of the Commonwealth'

Various attempts at uniform legislation:

- *Uniform Companies Act 1961*

- Commonwealth State Co-operative Scheme 1978 – scheme legislation referred to as *Companies Code 1981*
- *Corporations Act 1989* (Cth) – national scheme held to be unconstitutional by High Court in so far as it provided for incorporation of trading and financial corporations (*NSW v Commonwealth*)
- Corporations Law Scheme 1991 – scheme legislation referred to as Corporations Law – constitutional limitations revealed in High Court cases of *Re Wakim* and *Bond v R*

Current regime:

- Referral of Powers – States & Territories agreed to refer corporations powers to Commonwealth under s 51(xxxvii) of Commonwealth Constitution
- Legislation passed pursuant to the referral of powers – *Corporations Act 2001* (Cth) & *ASIC Act 2001* (Cth)
- Note – the *Corporations Act 2001* (Cth):
 - Is not a code covering all aspects of company law; and
 - Must be read in conjunction with case law

Current Regulatory framework:

- Key Legislation
 - *Corporations Act 2001* (Cth)
 - *Australian Securities & Investments Commissions Act 2001* (Cth)
- Key Regulatory Body
 - Australian Securities and Investments Commission
 - ASIC's role:
 - Commonwealth statutory corporation created under *Australian Securities and Investments Commission Act 2001* (Cth)
 - General function of administration of *Corporations Act 2001*
 - Specific functions:
 - Maintenance of national company register – computer database accessible to public with separate file for each company registered under the *Corporations Act* containing information such as directors details, registered office
 - Law reform: s 11(2)(b) *ASIC Act*
 - Surveillance and investigation: Pt 3 *ASIC Act* (e.g. ss 19, 28-39 *ASIC Act*)
 - Enforcement through initiation of civil proceedings and criminal prosecutions: ss 49-50 *ASIC Act*
 - Education by releasing policy statements, practice notes and media releases on ASIC's interpretation of the *Corporations Act*
- Securities Regulation
 - Chapter 7 *Corporations Act 2001* (Cth) as amended by the *Financial Services Reform Act 2001* (Cth)
 - Australian Securities Exchange (ASX)

INCORPORATION

The basics:

- **The Corporate Veil:**
 - Once a company is registered as a separate legal entity (is incorporated), a corporate veil exists which separates the corporation from its members and its controllers

- But courts may, occasionally lift the corporate veil by ignoring the separate personality of the company – when illegal acts have occurred
- **The effect of incorporation = separate legal entity/personality**
 - Incorporated company is a separate legal person in its own right
 - Separate from management and membership
 - Perpetual succession – e.g. directors come and go but this doesn't mean the end of the company – the company continues to exist
 - Can sue and be sued in own name
 - Can enter into contracts in own name
 - Can own property in own name
- **Internal governance rules:**
 - Company constitution – which is not compulsory (ss 134, 135(2) (*Corporations Act 2001* (Cth)))
 - Replaceable rules in CA (s 135(1))
 - Summary (s 141)
 - Illustration of internal governance rule (s 198A)
- **Internal management:**
 - Company governance model (s 198A)
- **Members:**
 - Members are essentially the owners of the company
 - Company must have members
 - Companies that have share capital call their members shareholders
 - Shareholders provide equity capital to company
 - Shareholders are the ultimate owners of company
 - Members have certain (limited) rights
- **Raising funds:**
 - Company with a share capital can raise money to carry on its business by issuing shares
 - Company may also raise capital by borrowing (e.g. issue of debentures)
 - Company may be required to issue a disclosure document (e.g. a prospectus under Chapter 6D *Corps Act*)
- **Dissolution:**
 - Company is capable of continuing indefinitely (perpetual succession)
 - Company may become insolvent or decide to discontinue business
 - Company is wound up or liquidated – liquidator is appointed to realise company's assets and pay its debts
 - Upon completion, a company is dissolved – it ceases to exist

BEFORE INCORPORATION

What happens before incorporation?

- **The promoter:**
 - **Who are promoters?**
 - Brings about the incorporation of a company

- One who undertakes to form a company...to set it going...who takes the necessary steps to accomplish that purpose (*Twycross v Grant*)
- Generally, a solicitor is not a promoter, they are an agent of the promoter – however, if a solicitor stands to make a personal gain over and above the gain for the legal work performed, they may be a promoter
- A company can be a promoter
- Tasks a promoter performs includes:
 - Preparing the constitution
 - Organizing registration
 - Raising funds
 - Entering into pre-registration contracts
- **Active vs passive promoters:**
 - *Tracy v Mandalay*:
 - Active = person who actively undertakes the formation of the company or actively acquires capital or investors
 - Passive = a person who takes no active part in incorporation but leaves this to others on the understanding that they will personally profit, may also be a promoter
 - Passive promoters still owe fiduciary duties and can be held liable
 - Ratio of *Tracy v Mandalay*:
 - Promoter's may sell their personal property to the company they are promoting but they are under a fiduciary duty to disclose this to the company they are promoting and disclose that they stand to make a personal gain
 - Must be done by disclosing to an independent board
 - Summary of facts of *Tracy v Mandalay*:
 - Defendant company purchased land to build units
 - The land was sold at a profit to the plaintiff company Mandalay Pty Ltd – set up by the defendant company
 - Mandalay attracted applicants for parcels of shares, with each shareholder entitled to the sole use of a unit
 - The units were never built
 - Mandalay sued the promoters to recover the moneys paid by its shareholders
 - Various shareholders of the defendant company that had initially purchased the land were held to be promoters
 - This included both persons actively involved in the scheme **and** persons who took no active part but who stood to profit **and** persons who had fallen out with the active promoters and stood only to recover their original contributions
- **What are promoters' fiduciary duties?**
 - Similar to, but not equal to directors' duties
 - Promoters owe fiduciary obligations as long as they are a promoter
 - The promoters of a company...are treated as a category of 'accepted' fiduciary relationships (*Elders Trustee and Executor Co v EG Reeves*)
 - As fiduciaries, they are required to:
 - Act in good faith for the benefit of their fledgling company; and

- Avoid placing themselves in a position where there is a real sensible possibility of conflict between their duty and their personal interest
 - *Aequitas v AEFC*
 - *Gluckstein v Barnes*
- **What are the remedies for breach of promoters' duties?**
 - It is usually the newly formed company that will seek remedy against the promoter
 - Potential remedies include:
 - Rescission (*Tracy v Mandalay*)
 - Right to rescind **not** available if:
 - The company, through an independent board, affirms its purchase after full knowledge of the facts;
 - The parties cannot be restored to their pre-sale situation (e.g. where the company cannot restore the property); or
 - Innocent third persons have acquired rights in the property in the meantime
 - Rescission + damages are available in cases of fraudulent misrepresentation
 - Rescission + equitable compensation (*Tracy v Mandalay*)
 - Account of Profits (*Gluckstein v Barnes*)
 - Only where acquired in the scope of fiduciary relationship
 - Constructive Trust
 - Statutory Liability (e.g. promoters liable for non-disclosure – ss 728-729 *Corporations Act 2001* (Cth))
 - Damages (*Re Leeds and Hanley Theatres of Varieties*)
 - Where breach is fraudulent
- **Issues with pre-incorporation contracts:**
 - **Common Law Position:**
 - Prior to registration, a company did not exist so...
 - It could not enter into binding contracts;
 - It could not appoint an agent to act on its behalf;
 - It could not ratify pre-registration contracts (*Kelner v Baxter*)
 - **Law Reform:**
 - In 1981, report by Victorian Law Reform Commissioner proposed that the promoter should bear the greater share of the risk that the company would not be incorporated or that the company would not honour the obligation which the promoter would have it assume
 - The legislative position now appears in ss 131-133
 - **Now, contracts must be ratified:**

Section 131(1) = if a person (*promoter*) enters into, or purports to enter into, a contract on behalf of, or for the benefit of, a company before it is registered, the company becomes bound by the contract and entitled to its benefit if the company, or