

# CORPORATION LAW

## CONTENTS

- Topic 1: Introduction to corporation law ..... 4
  - What is a company ..... 4
    - Sole trader ..... 4
    - Partnership.....5
    - Co-operative .....5
    - Unit trust.....5
    - Incorporated associtaion ..... 6
    - Company..... 6
  - Development of corporate law and framework ..... 6
  - Corporation regulators .....7
  - Corporate Theories..... 8
- topic 2: Incorporation and its effects ..... 8
  - Creating a separate legal entity ..... 8
  - doctrine of separate legal entity..... 8
  - Lifting the corporate veil.....10
  - Insolvent Trading.....12
    - who is a director .....13
    - Incur a debt .....13
    - insolvency .....13
    - reasonable grounds for suspecting insolvency.....14
    - Prevent company incurring a debt .....15
    - Defences .....15
- Topic 4: The constitution and replaceable rules .....16
  - Company powers, objects clauses and abolition of ultra vires .....17
  - constitution as a statutory contract.....17
    - remedies for breach of statutory contract .....18
  - Ammending the constitution .....19
  - aLTERATIONS OF THE CONSTITUTION – EQUITABLE LIMITS .....19

topic 5: Share capital, debt capital and dividends.....	21
companies obtaining capital .....	21
Topic 6: Directors, members and corporate decision making .....	30
division of power between directors and shareholders .....	30
Board of directors.....	31
resignation, retirement and removal.....	33
Members .....	35
Topic 7: corporate contracting .....	39
COntacts entered into directly by the company .....	40
contract through an agent .....	40
indoor management rule at common law .....	44
statutory assumption.....	45
topic 8: Director's duties.....	48
nature, regulation and corporate governance .....	48
purpose and sources of director duties .....	48
Duty to act in good faith and in the best interest of the company .....	49
equity.....	49
Proper purposes .....	54
statutory duties .....	56
duty to retain (or not to fetter) their discretionary powers .....	57
Common law: conflict rule, profit rule, missappropriation rule.....	57
the conflict rule.....	57
profit rule .....	58
missappropriation rule .....	59
Duties not to misuse company position and information – Statutory rules – Sections 182 – 184.....	62
Disclosure of material personal interests – Statutory rules, S191-195 .....	63
Related party benefits regime – Statutory rules,s9, Ch 2E (s207-229), s50AA.....	64
duty of care, skills and dilligence .....	64
historical views .....	64
the test.....	66
statutory business judgement rule – defence .....	72

Can directors avoid liability through reliance and delegation .....	74
topic 9: Consequences of director duty breaches .....	75
general law penalties .....	75
statutory penalties .....	75
statutory criminal penalties .....	76
exoneration by company .....	76
relief by courts .....	77
topic 10: Member remedies .....	78
Statutory derivative action → proceedings on behalf of company .....	78
Action for oppressive conduct .....	80
examples of oppressive conduct .....	81
winding up as a member's remedy .....	82
Statutory injunctions to prevent a contravention of the act .....	83
personal actions .....	84
other rights .....	84
topic 11: Corporate morality .....	85
insolvency .....	85
receivership .....	85
voluntary administration .....	86
liquidation .....	87

## CORPORATE THEORIES

### Fiction or concession theory

- Corporation exists due to the law and is a creation of the state and should be regulated by the state

### Realist or natural theory

- It is not a creation of the law but a separate and distinct entity that is the production of social interaction. It is not public but rather a product of private relationships. Less focus on regulations, except perhaps where there are "negative externalities" (negative effect on others) which would then justify regulations

### Economic or contractarian perspectives

- Corporations are internal marketplaces in which bilateral contractual transactions are carried out between: Corporation's shareholders; and Corporation's managers.
- Economists regard the corporation a nexus of contracts; thus the description "contractarian approach". Thus, serve the benefits of the shareholders (primacy of shareholders).

### Progressive or communitarian perspectives

- Progressive view the corporation as a real social and more than some bilateral contract. Focus on the total effects corporations have stakeholders including the community therefore challenges the shareholder primacy view held by the economic perspective. Corporations as a social institution operating within a community

## TOPIC 2: INCORPORATION AND ITS EFFECTS

### CREATING A SEPARATE LEGAL ENTITY

- Company is a corporation and s57A gives a tree of different types of corporations
- Some are through charters, legislation or registration
- S119 states that the company begins to exist on the day of its registration
- S117 sets out steps to be followed for the registration process – ASIC Form 201
- After registration the company can operate in any state in Australia
- S114: Company can be formed with one or more members
- S124: a company has the capacity and powers of an individual and more – such as issue security

### DOCTRINE OF SEPARATE LEGAL ENTITY

- At common law, the term 'body corporate' and 'corporation' are used interchangeably to refer to any type of artificial legal person created and recognised by the law. Corporation is defined broadly to include companies as well as other body corporates – s57A(1)
- When a company is corporate it is a separate legal entity therefore, creating a corporate veil between the owners/directors and the company.

### **Salomon v Saloman & Co Ltd (READ)**

**Facts:** Aron Salomon made his sole trader business into a company through registration and selling the business to himself. In that time, you needed 7 shareholders to incorporate a company, therefore, he got dummy shareholders to make the numbers but still owned 99% of the shares. He paid himself a lot of money, made up of shares, cash, debenture and discharge of debts. He also recognized himself as a secure creditor. After the company went down he exercised his right and claimed right to assets of the business over other creditors (through his debenture).

Creditors argued that this is an exploitation of separation between owner and company: this is fraud (paying unreasonable amount), breached fiduciary duties (as a director need to look after interest of the company) and he is a vendor must receive best price (there was conflict of interest), company is an agent for Salomon as such required him to indemnify the debts, the company held the business **on trust for Salomon**

**Held:** Trial judge found that Mr. Salomon's business was a trust and was not legal. On appeal, it was held that this would be a scandal. The House of Lords, by unanimous decision held in favour of Aron Salomon. They held that if you incorporate a company and no matter what is the idea behind it, the company is a separate legal entity.

### **Lee v Lee's Air Farming Limited (READ)**

**Facts:** Lee was formed a company and held 2999 shares out of the 3000 shares on issue and was the company's governing director. Mr Lee entered into a contract with the company to work as a chief pilot. He died through a plane crash and his widow claimed workers' compensation insurance. The insurer argued that Mr Lee could not be a 'worker' as that term was defined in the relevant legislation. This was on the basis that there could not be a true employer/employee relationship because Mr Lee was both.

**Held:**

- The decision in Salomon's case that one person may function in dual capacities.
- contractual relationship can be created as between the deceased and the company.
- If this stage is reached then their lordships see no reason why the range of possible contractual relationships should not include a contract for services, and if the deceased as agent for the company could negotiate a contract for services as between the company and himself there is no reason why a contract of service could not also be negotiated.
- It is said that therein lies the difficulty, because it is said that the deceased could not both be under the duty of giving orders and also be under the duty of obeying them.

### Macaura v Northern Assurance Company

**Facts:** Mr Macaura incorporated a new company and sold his timber farm to that company. He received all of the shares in the company. Macaura then took out insurance policies over timber but the policies were under his name. The timber farm was destroyed by fire and Macaura's insurance claim was denied on the basis that only the company had an insurable interest in the timber farm and it was not the holder of the policy.

**Held:** the company was a separate legal entity so the insurance policy could not be transferred.

## LIFTING THE CORPORATE VEIL

Although the principle in Solomon case holds up, it does give rise to fraudulent behavior, therefore, the court has in certain circumstances where it has pierced the corporate veil. This has also been recognized in legislation.

- Common law: it has been lifted when company is utilized as a sham or a façade. There are two principles where a court **MAY** look beyond incorporation (Prest v Petrodel Resources Ltd, Lord Sumpton):
  - "evasion principle" where the company is interposed to evade a legal obligation (pierces the corporate veil)
  - "concealment principle" where the company is interposed to conceal those behind it (lifting the corporate veil).
- Legislation: a statutory exceptions that it is illegal for a company to trade while insolvent, Consolidated financial statements (s 296) – Parent company must prepare consolidated financial statements, Can elect to submitted a consolidated tax return from the entire group, Pooling in in liquidation: each company in the group is taken to be jointly and severally liable each debt payable by, and each claim against, each other company in the groups

### Smith, Stone and Knight v Birmingham Corporation

**Facts:** there was a holding company that had a subsidiary who conducted business on land that it leased from the holding company. The holding company was a shareholder and the land the business was conducted upon compulsory acquired by the council. The owner (holding company) was to get compensation due to the compulsory acquisition but it was the subsidiary that conducted the business – however, in order to get the compensation, it was supposed to have tenure of more than 12 months which was not met.

**Held: Atkinson JL** in certain circumstances it was successfully argued that the subsidiary was conducting the business as its agent. Therefore, it was the company's business and the holding company's business that was disrupted. There were several things considered like relationship between the companies, the directors are the same, equipment is same or controlled by parent company, who is making the decisions.