

WEEK 1 - Separate legal entity doctrine + Limited liability

- ❖ **Company:** Corporation registered under Corporations Act
- ❖ **Controllers = Members & Directors**
- ❖ 2 types of capital structure:
 1. **Equity capital:** Funds contributed by shareholders
 - 2 adv → Dividends is discretionary + Lower liquidity risk
 - 2 disadv → Ownership structure is affected + Higher Cost of capital
 2. **Debt capital:** Funds borrowed from creditors
 - MUST be repaid whether or not company is profitable
 - If a company fails to repay its debts, it becomes insolvent and will be liquidated
 - Repayment priority during liquidation:
 - Secured creditors → Unsecured creditors → Preference Shareholders → Ordinary shareholders

What are shares & rights?

- ❖ **Class rights:** The rights attaching to shares
 - = **Voting rights + Dividends rights**

Separate legal entity doctrine

- ❖ **Separate legal entity doctrine:** Company is a separate legal person
 1. Company is separate from its controllers
 - **Salomon v Salomon:** S is both shareholder & secured creditor. → Mr S is entitled to be repaid.
 2. Company can contract with its controllers
 - **Lee v Lee's air farming:** Lee is both controller & employee. Later died in work incident. → Wife can claim worker insurance.
 3. Company's property is not the property of its controllers
 - **Macaure v Northern assurance:** M transfer forest to his firm, later ruined by fire. → He can't get insurance. Forest is owned by firm.
 4. **s124:** Company can legally do most things that humans can do, plus some extras (eg. issue shares)
 5. Can hold rights and incur obligations
 6. Can sue and be sued in its own name

Members' Limited liability + Liability to pay on call

- ❖ **Limited liability:** Company debts are paid by the company, not its shareholders
 - **s516:** A shareholder's liability to company debts is only limited to the amount unpaid on their shares
- ❖ Company can issue shares payable on instalments
 - **s254M:** If a "call" is made, shareholder is obliged to contribute further
 - If call is not paid, shares can be forfeited

WEEK 2 - Setting up companies + Corporate group + Internal governance rules

2 forms of entities: (NOT important)

1. **Unincorporated entities:** Entities that have no separate legal entity from their participants
2. **Incorporated entities:** Entities that have separate legal entity from their participants
 - Can hold property, enter into contracts, can sue or be sued in its own name

❖ 6 advantages of becoming a company:

1. Can raise more funds from the public
2. Have limited liability
3. Have perpetual life
4. Free transferability of ownership
5. Company law acts as a standard form contract between participants
 - Reduce uncertainty & cost to seek advice
6. Different tax treatment → imputation tax
 - May help shareholders to reduce personal tax

❖ 2 disadvantages:

1. High cost on formation & compliance
2. Expose information to the public

'Piercing the corporate veil' 揭开公司保护面纱

❖ Usually, company debts are paid by the company, not its shareholders

Piercing the corporate veil: Make the shareholders liable for company debts

❖ Only applied by the court under limited circumstances:

1. General law - When corporate form is used to avoid legal duty 逃避责任
 - **Gilford motor company v Horne:** H sign 'non-compete' clause with company. Later resign & set up firm with wife as sole member. → Firm is used to avoid legal duty. Court disallow formation.
 - **Jones v Lipman:** L sell land to J. Later transfer land to his firm. → Firm is used to avoid contractual obligation. Court applies the obligation on the firm.
2. **s588V:** When corporate form is used during insolvent trading 逃避债务

2 ways to classify a company:

1. By proprietary or public OR
2. By the extent of member's liability:
 - a. No-liability company(**public only**) (no-liability)
 - Only for mining companies
 - b. Company limited by shares (limited)
 - c. Company limited by guarantee(**public only**) (limited)
 - Only for NPOs → no dividends
 - d. Unlimited company by shares (unlimited)
 - Usually law / accounting firms must be unlimited

Classification as public or proprietary:

1. **Proprietary company**(Pty Ltd) (inward-looking company)

- Can be small or large proprietary company
 - **s45A:** Large if satisfy 2 or more conditions below:
 1. Gross assets at the end of FY > \$12.5 million
 2. Gross revenue for the FY > \$25 million
 3. > 50 EFT employees at the end of FY
- **2 Adv:**
 - More flexibility
 - More privacy

s112: Can only be a company limited by shares OR unlimited company by shares

s113:

1. Cannot have more than **50** non-employee shareholders
2. Cannot hold offer shares that requires a disclosure document under Ch 6D

s148(2): Must include "**Pty Ltd**" it its name

s201A: Must have **1** or more directors

2. **Public company**(Ltd): (outward company)

- Can be listed or unlisted

2 adv:

1. Can raise more funds from the public
2. Can have unlimited number of shareholders (**s113:** proprietary cannot have >50)

3 disadv:

1. More procedures (less flexibility)
2. More publicity (eg. disclosure requirements)
3. Subjected to stricter rules

s112: Can be any 4 types of company (no-liability / limited / unlimited)

****s201A(2):** Must have **3** or more directors

WEEK 11 - Consequences of breach of duty + Members' remedies

2 types of Enforcement of duties AND Remedies:

1. **Statutory duties** → Enforced by **ASIC**
 - 3 Consequences → [s206C](#), [s1317G](#), [s1317H](#): Disqualification, penalty, compensation(losses)
2. **General law duties** → Enforced by **Companies** (NOT members)
 - 6 Remedies → [s1317H](#): Compensation + **5 general law remedies**

What can ASIC do? - Breach of Statutory duties & provisions:

(1st) Breach of CIVIL penalty provisions	CRIMINAL offences (Intentional 有计划)
<p>7 Statutory duties:</p> <ol style="list-style-type: none"> 1. Breach of s180, 181, 182, 183, 588G = Breach of civil penalty provisions 2. Breach of s191 & s195 = NEVER <p>5 Statutory provisions:</p> <ol style="list-style-type: none"> 1. Breach of s208 259 + 257 260 256 <ul style="list-style-type: none"> ➢ s209(2) 259F(2) 260D(2) 256D(3) <p>**Consequence:</p> <p><u>ASIC</u> can apply to court AND <u>Court</u> can make 3 orders:</p> <ol style="list-style-type: none"> 1. s206C: To disqualify the person from managing the company 2. s1317G: To pay a penalty up to \$200,000 3. s1317H: To pay a compensation(losses) <p>*Can directors be forgiven?</p> <ul style="list-style-type: none"> ❖ s1317S: Directors can be forgiven IF: <ol style="list-style-type: none"> 1. They acted honestly AND 2. Just & equitable to do so 	<p>7 Statutory duties:</p> <ol style="list-style-type: none"> 1. Breach of s180 = NEVER 2. Breach of s181, 182, 183, 588G = IF recklessness OR dishonesty <ul style="list-style-type: none"> ➢ s184(1,2,3), s588G(3) 3. Breach of s191 = s191(1A) <ul style="list-style-type: none"> ➢ Consequence → Fine \$2100 OR Imprisonment 4. Breach of s195 = s195(1B) <ul style="list-style-type: none"> ➢ Consequence → Fine \$1050 <p>5 Statutory provisions:</p> <ol style="list-style-type: none"> 1. Breach of s208 259 + 257 260 256 = IF dishonesty <ul style="list-style-type: none"> ➢ s209(3) 259F(3) 260D(3) 256D(4) <p>***Consequence</p> <ul style="list-style-type: none"> ❖ Fine up to \$420,000 OR Imprisonment

Week 7: The Duty of care & diligence + Insolvent trading

Summary: s180 + 588G

1. Central Ltd is a listed public company which owns and manages many shopping centres in Melbourne. It has 7 directors – Andrew, its CEO; Brian, the Chair of the board who is an experienced businessman; Sam, its chief financial officer; Paul, a lawyer and the company secretary; Jim, a non-executive director who is also an accountant; and two other non-executive directors who have a great deal of previous board experience, Bill and Michael. Due to a downturn in retail business and the closure of many shops in the centres, there has been a significant decline in profits. Central owes a large amount of money to various lenders which is repayable within the next 12 months. The company's financial statements have been prepared by WPC, one of the largest accounting firms in the country. The financial statements are approved by the Board at a board meeting and released publicly.

The accounts are very lengthy and complex and the board do not read them closely. Unfortunately, they contain significant errors and omissions which do not disclose the true state of the company's indebtedness. Advise ASIC whether there are grounds for bringing civil penalty action against the board members of Central.

- ****Advise ASIC** → Statutory duties **VS. Advise company** → General law duties

Question 1 → Can ASIC to bring consequences of breach of civil penalty provisions against the board?

- 1) *What duties have the directors breached?
- 2) *Can they use any defences?
- 3) What are the consequences of breach of civil penalty provision(EXTRA)

Issue 1: What duties have the directors breached?

1. **Rule 1 - s180.** All 7 directors have a duty to act with reasonable care & diligence
 - **Rule 2 - Daniels v AWA:**
 - Directors did not read the financial statements closely = did not monitor financial position of the company
 - **Conclusion** → The directors **breached s180**
 - **(EXTRA) Rule 3 - ASIC v vines:** Since 5 directors have special skills, they are subjected to a higher standard of care
 - This means that these people are likely to get higher penalty
2. **Rule 2 - s182:** All directors must not improperly use their position to cause harm to company
 - **R v Heilbronn:** Since directors did not approve the statements by taking proper steps = Improper use of their position AND breached s182

Issue 2: Can they use any defences?

1. **Rule 1 - s189:** Directors can rely on information given by other people
 - The financial statements are prepared by the accounting firm(professional advisors)
 - **BUT** the reliance is not made after independent assessment
 - **ASIC v Healey:** Directors also cannot rely on other people on important matters
 2. **Rule 2: s180(2):** Business judgement rule can only be used for operational judgement
- Therefore, the directors cannot use **s189** OR business judgement rule to avoid their liability of negligence.

Conclusion → Since the directors breached their duty of care and diligence AND they cannot use the defences = ASIC can bring civil penalty actions against them

(EXTRA) Issue 3 → What are the consequences of breach of civil penalty provision?

Since the directors have breached the statutory duties, ASIC can make an order:

1. **s206C:** To disqualify the 7 directors from managing the company
2. **s1317G:** To pay a penalty up to \$200,000

Question 2

2. Based on the facts in Question One above, would the directors be liable under s 588G if the Board had decided at its meeting to borrow substantially to expand their business, and then the company couldn't repay that new debt? Would it make a difference to Bill and Michael's liability that they were based overseas and hadn't participated in this particular board meeting?

Question 1: Are the directors liable of s588G?

Issue 1 - Do the directors have duty to prevent insolvent trading? Are the directors liable of insolvent trading?

1. **Rule 1** → All directors have a duty to prevent insolvent trading: **s588G(2)**
2. **Rule 2** → Borrow substantially = Debt was incurred
3. **Rule 3** → **s588G(1)**: A person is liable of insolvent trading, IF they satisfy 4 conditions:
 1. All directors were directors when the debt incurred **AND**
 2. The company was not insolvent when the debt incurred, BUT it later became insolvent because of the debt, when it fails to repay its maturing obligations: **s95A(2)**
AND
 3. Given the "downturn in retail business", "closure of many shops", and "significant decline in profits" → Reasonable grounds to suspect insolvency **AND**
 4. Not mentioned that directors actually suspected insolvency **BUT** a reasonable person, who does the same job in the same company, **is likely to suspect**

Issue 2 - Can they use any defences?

1. **Rule 1** → **s588H**: A director is not liable of insolvent trading IF ...
 - BUT none of the defences can be used

Conclusion → Since the directors cannot use the defences = All 7 directors are liable of insolvent trading.

****Question 2: Can Bill & Michael use defences to avoid their liability of insolvent trading?**

Rule 1 → **s588H(4)**: A director is not liable of insolvent trading, IF when the debt incurred, the director was absent from management due to a good reason.

- Bill and Michael did not participate in board meeting due to location OR job reasons
- BUT the court may hold that this does not amount to a good reason, since it **does not** affect their requirement to participate in management + they can join board meeting using technology: **s248D**.

Rule 2 → **s588H(3)**: NOT reasonable to rely on other directors due to location OR job reasons

Conclusion → Unless B&M can provide other good reasons of absence from management, the court is likely to hold that they are liable of insolvent trading: **s588H(4)**

Kiran, Cindy and Yi are siblings who jointly own Grand Prix Cars Pty Ltd (GPC), a car sales business. The managing director and chair of the board is Kiran, with Cindy (an accountant) and Yi (an engineer) as non-executive directors. Kiran does not bother to hold regular board meetings, and Cindy and Yi pay no attention to the business of the company.

GPC is not doing well financially. The company is often late in paying the mortgage on the company's showroom to YBank, and it has not paid wages for its employees for a month. Kiran has his own financial problems. He sells an expensive car to a customer who is willing to pay \$5,000 cash, and pays himself a dividend with the money. He records these transactions in the company's accounts although he doesn't tell Cindy or Yi about them.

YBank then has GPC placed into liquidation because of the non-payment of the mortgage.

Advise whether there have been any breaches of directors' duties by any of the directors, and what defences, if any, are available. Do not discuss s 181, s 182 or s 183.

Question: Advise IF any directors breach their **statutory AND general law Duties AND defences** they can use (EXCL 181, 182, 183)

Issue 1: s180: All directors AND officers MUST act with reasonable care & diligence

1. **Daniels v AWA**: All directors **did not act with reasonable care**:
 - Kiran did not attend board meeting regularly
 - Cindy & Yi did not keep themselves informed about AND monitor company's activities
2. **ASIC v Vines**: Since they all have special skills & position = **Breach higher standard of care**
3. s180(2): They cannot use business judgement rule:
 - All 3 directors **did not inform themselves**
4. **Conclusion**: They all cannot use defences → **All directors breach s180 AND General law duty to act with care & diligence**

Issue 2: s588G(2): All directors MUST prevent insolvent trading

1. s588G(1A) Pay a dividend = **Incur a deemed debt**
2. s588G(1): A person is liable of insolvent trading IF they satisfy all 4 stated conditions:
 - a. When debt incurred, **Kiran, Cindy AND Yi were directors**
 - b. Company **was insolvent** when Kiran pays himself dividends = Fails to pay wages as they fall due: s95A(2)
 - c. GPC is often late in paying mortgage + Has not paid wages = **Reasonable grounds to suspect insolvency**
 - d. A reasonable person, who does same job in same company, **would suspect**
3. s588H: No defences can be used
4. **Conclusion**: **All directors breach s588G**

Issue 3: s191(1): All directors must disclose material personal interest to other directors

1. ****McGellin**: Pay a dividend of \$5000 → Relate to company's affairs + Benefit Kiran directly + Amount to a material interest = **Kiran breach s191**
 - **Material interest** = Interest that affect Kiran's vote on decision