

Topic 1: Introduction to Corporations Law

“A company is an artificial entity recognised by the law as a legal person with its own rights and liabilities” *Lipton, Herzberg and Welsh (2012)*

Companies compared with other business structures

1. Sole Trader

- The term ‘sole trader’ refers to an individual **conducting a business alone** w/o the benefit of any legal structure or entity status distinct from that of the individual who conducts it.

Advantages	Disadvantages
<ul style="list-style-type: none">○ Straightforward business structure○ High degree of control by owner○ Commercial privacy○ No specific regulation○ Retention of profits○ Ownership of assets○ - Easy to terminate	<ul style="list-style-type: none">○ Unlimited legal liability (i.e. personal asset remains at risk)○ Limited options in terms of offering security (e.g. not possible to grant a floating charge over business assets)○ Transferability of business is problematic○ Tax consequences – Personal rate of income tax may be higher than the company rate

2. Partnership

- **Two or more people** (can be natural persons or artificial legal persons) carry on a business in common with a **view to profit**. People in partnership are collectively a “firm”. **Not a separate legal entity.**
- Partners are agents for each other – can make Ks binding on other partners; Partners usually try to cover contingencies related to their r/ship in a K’ual doco called the **partnership deed**.
- There may be 2 types of partners:
 - **active partners** (unlimited liability)
 - **passive partners** (limited liability).
 - If a partner takes an active role in management, then he can automatically lose his limited liability status.
- Some professions must constitute themselves as partnerships, as the law under which that profession is recognized requires that the partners accept unlimited liability.
- **CA** limits membership to **20 persons**: **s115** for transparency; but exceptions under **Corps Regs** → doctors, max = 50; lawyers, max = 400; accountants max = 1000.

Advantages	Disadvantages
<ul style="list-style-type: none"> ○ Very easy to establish – Can be based on an oral agreement ○ No registration requirements ○ Freedom to tailor arrangement pursuant to terms of agreement ○ A clear common goal (to profit) ○ Limited liability partnerships available in certain circumstances ○ A legislative framework that will ‘fill the gaps’ 	<ul style="list-style-type: none"> ○ No separate legal entity ○ Written partnership agreement recommended which will usually require legal advice and input of all partners ○ Automatic dissolution in certain circumstances unless partnership agreement provides otherwise ○ Partners remain jointly and severally liable for defaults of other partners ○ Number of partners limited under s 115 of the Corps Act

3. Company

Advantages	Disadvantages
<ul style="list-style-type: none"> ○ A separate legal entity created with the powers of a natural person and more ○ Simple registration process ○ A range of types to choose from (most types limit the liability of members) ○ Clear distinction between ownership and management (owners do not need to get involved) ○ Company tax rate applies ○ Range of security may be given by the company 	<ul style="list-style-type: none"> ○ Expensive to register and maintain (compared to other forms of business structures) ○ Ongoing regulatory requirements (can be expensive) ○ Compliance with Act required by all companies (even small Pty Ltd companies) ○ Limited options for owners to get involved in management decisions (power to manage is vested in directors) ○ Restrictions on transfers of shares for some company types

Topic 2: Registration and its effects

Corporation is defined by s57A(1) of the CA.

Incorporation through registration

1. Registration Rule (s 117)

- a. All companies that wish to carry on business in Australia must be registered under the *Corporations Act* with ASIC
- b. A person must lodge an application in the prescribed form with ASIC Type of company s.117(1)
 - i. Company's proposed name (ss 147-156)
 - ii. Replaceable rules or constitution
 - iii. Registered office and principal place of business of the company (s 117(2)(g))
 - iv. Name, address & DOB of each director / company secretary (s 117(2)(e) – (f))
 - v. Name and address of each member (s 117(2)(c))
 - vi. Details of any holding company
 - vii. Share structure

2. Certificate of Registration S 118

- a. ASIC issues the company with a certificate of registration and Australian Company Number (ACN)
 - i. Certificate is conclusive evidence that all requirements have been complied with and company validly registered (s 1274(7A))

3. Existence on the Day S 119

- a. A company comes into existence at the beginning of the day on which it is registered
- A company may be formed with one or more members (s114)
 - Only no liability companies require specific purpose for formation
 - A company may acquire and dispose of property, enter into Ks or sue and be sued (s124)

Company Name

- ASIC may give the company a name through the 9 digit company number.
- If incorporators do wish to give the company a name, it must use a name that is available. A name will be available to a company unless:
 - It is identical to a name that has already been reserved or registered (s147(1)(a))
 - It is identical to a name included on the national business names register (s147(1)(b))
 - It is unacceptable (s147)(1)(c)
 - A name which in the opinion of ASIC is undesirable or likely to be offensive (“Virgin Mary Pty Ltd”)
 - Cannot contain phrases which imply a connection with the government, royal family or Sir Donald Bradman

- Cannot contain words or phrases which imply a purpose or status that would be misleading, for example 'stock exchange'.
- A company's name (even if it is using its ACN as its name) but reflect its status as per **s148**. For e.g.
 - A limited public company must have the word 'limited' at the end of its name (unless an exemption has been granted by ASIC in relation to a public company limited by guarantee) (**s148(2)**)
 - A limited proprietary company must have the words 'Proprietary Limited' at the end of its name (**s148(2)**)
 - An unlimited proprietary company must have the word 'Proprietary' at the end of its name (**s148(3)**)
 - A no liability company must have the words 'no liability' at the end of its name (**s148(4)**)
- **S 149** sets out some acceptable abbreviations e.g. PTY Ltd, Ltd, NL.

Separate Legal Entity Doctrine

State: A company is a separate legal entity from its members, which means it bears its liability in its own name (*Salomon; Lee*) prima facies preventing any claims against [independent holding company] by [creditors of its subsidiary]

- A company has the legal capacity and powers of an individual and attributes of a body corporate. A legal distinction (a veil) exists b/w co and board, its s/h and employees b/c a co is separate form its incorporators: *Salomon*.
- The property of the company is not the property of its members: *Macaura*

Case Law

Salomon v Salomon → Established legality of one person companies and represented that the public deal with companies as separate legal entities which conduct business on own.

Lee v Lee's Air Farming Pty Ltd → A person can act in two capacities; as organ of the company and employee of the company.

Corporate Groups

Definition: A corporate group is "a number of companies which are associated by common or interlocking s/h, allied to unified control of capacity to control" (*Walker v Wimborne*)

- *Salomon's* principle means that each company in a group is a separate legal entity distinct from other companies in the groups – e.g. holding company is not liable for subsidiary's breach
- As each co is separate within the group, undistributed profits of subsidiaries in a group cannot be used to support the payment to the SH of the holding company: *Industrial Equity*

- Each company is a separate and independent legal entity and directors must consult its interests alone in making payments to other “group” companies: *Walker v Wimborne*

HD Point (Policy): Given corporate groups are common, perhaps law should recognise whole groups as legal entities, as opposed to each company being separate.

Degrees of control

- 50% of votes cast – ordinary resolution (e.g. to appoint/remove directors)
- 75% of votes cast – special resolution (e.g. to amend constitution)
- 90% - may allow compulsory acquisition of remaining 10%
- 100% - no minority interests to consider

Two approaches to identify corporate groups –act encompasses both tests and both are correct used in different situations

1. Formal holding company/subsidiary relationship (Narrow Approach)

- Two companies are ‘related’ if they are in a holding-subsiary relationship: **s50**
- **S46** pertains to when a company is a subsidiary of another (if one has enough shares to legal control other)
- Older approach, black letter approach – precise and predictable

- **S46** A body corporate [1st co] is a subsidiary of another co [2nd co, holding co] if:
- **(a)** the 2nd co:
 - **(i)** **controls the composition of the board** of the subsidiary (see **S47** below for def of ‘board’) [*must be actual, not de facto or practical*]; or
 - **(ii)** **can control > 50% of voting** power (in a **position to cast or control** the casting of > 50% of the maximum **votes** that might be cast) at the subsidiary’s general meeting.
 - **(iii)** **holds > 50% of the shares**/issued capital (excluding issued share capital that carries no right to participate beyond a specified amount in a distribution of either profits or capital – normally preference shares) = registered SH. or
- **(b)** the 1st co is a sub of a sub of other body [∴ **sub-subsidiaries** are also regarded as subs of the ultimate parent]

Holding company (s9)

- Controls composition of its board (legal control not de facto: *Mount Edon Gold Mines*)
- Controls casting of >50% of max. votes at its general meeting (“present ability” e.g. proxy enough: *Bluebird Investments*)
- Holds >50% of its issued shares (excl. limited participation shares)

2. Test pertaining to the degree of control that entity has over another (s50AA) (Wide Approach)

- Newer approach – imprecise and uncertain
- Related if one has practical control over the other
- Look at:

- Practical influence (rather than rights)
- Any practice of pattern of behaviour (even if it involves breach of trust)

Case Law

Walker v Wimborne → Courts recognise the separate legal entities of each company in the corporate group

Industrial Equity Ltd v Blackburn → A parent company cannot use subsidiary profits to pay dividends to parent company's shareholders

Mount Edon Gold Mines (Aust) Ltd v Burmine Ltd → De facto control in the absence of power is not enough.

Bluebird Investments Pty Ltd v Graf → Some arrangements short of actual control may suffice the creation of holding/subsidiary r/ship where putative holding company is in position where it can cast more than 50% votes.

Lifting the Corporate Veil

- Piercing the corporate veil is an exception to the general doctrine of separate legal personality as exemplified in *Salomon*.
- Set up to prevent members and directors from avoiding liability for setting up companies to incur debts, whilst own liability was limited.
- Where the veil is pierced, the liabilities of the company will be treated as a liability of either the member or the director in place of or in addition to the company.
- The company still exists; however, the veil becomes transparent so that the company's liability can be ascribed to the member/director.

Two methods of lifting the veil:

- (1) Via CL → Generally develops slowly
- (2) Statute → Permits fast and extensive changes

VIA CL

- English/US courts more willing to lift veil, however lack of consistency in Aus.

1. Agency

State: "A lifting of the veil due to an agency presupposes two distinct and separate parties (agent and principal). In Aus, it is difficult to prove a r/ship of agency"

Three requirements for veil to be lifted due to agency

- (A) There is an agent corporation
- (B) There is a principal/parent corporation
- (C) There is a r/ship of agency between agent and principal corporation

Per Atkinson J in *Smith Stone and Knight*, the follow suggest existence of Agency r/ship

- (1) Were the **profits** of the business (sub) treated as profits of the parent?
- (2) Were the **responsible persons** carrying on the business **appointed by the parent**?
- (3) Was the parent the **head & brain** of the trading venture?
- (4) Did the parent **govern the adventure**, i.e. decide what should be done & what capital should be embarked on the venture?
- (5) Did the parent make the profits by its **skill & direction**?
- (6) Was the parent in **effectual & constant control**?

HD Point: probably need all 6.

HD POINTS:

- 100% ownership of AC by PC ≠ a determinant factor: *Smith Stone*
- In Australia, courts have adopted a strict approach, hard to prove r/ship of agency: *Walker v Wimborne* [re dir's duties in group cos where HC held that each co in group = separate legal entity]; *Glavanics (1999)*; *Briggs (1989)*
- Agency has only been found in extreme facts that clearly indicate that AC was in effect and administrative arm of the PC: *Smith Stone*; *Re FG Films*
- The agency approach is of questionable merit b/c *Salomon* specifically rejected it

Case Law

Smith Stone and Knight v Birmingham Corp → It is too simplistic to say that the veil may be pierced where a holding company exercises some control or dominion over the subsidiary, however, tort claimants may be able to pierce veil.

Briggs v James Hardie & Co Pty Ltd → Lacked predictive principles to pierce veil

2. Fraud or avoidance of existing legal obligation

- Corporate veil will be lifted where a company is set up as a device for purpose of evading a presently existing legal obligation (*Gilford Motor Co*)
- Examples of obligations:
 - Contractual obligation (*Gilford Motor Co*)
 - A court order (*Jones v Lipman*)
 - The court may grant injunction (*Gilford*) or SP (*Lipman*)

Case Law

Gilford Motors v Horne → If company is formed as device to avoid liability, corporate veil can be pierced

Jones v Lipman → SP will be granted as remedy for piercing veil

3. Statutory Interpretation

Re Bugle Press → Unable to acquire minorities shares to get around stat provision

4. Corporate personality w/in corporate groups

- No Aus court has ever lifted veil b/w parent and sub company's in corporate group
- But, if contract, mention *Smith Stone* – in some cases, UK courts willing to pierce.
- Conclude: If we do follow, will apply 6 factor test in *Smith Stone*.

Policy: Ct are reluctant to lift the veil b/c as long as the law allows the establishment of corporate structures, the consequence of corporate form must be taken for better or worse: *Morgan* per Young J. So *Salomon* is still being applied.

VIA STATUTE – Insolvent Trading Provisions (ss588G-H, ss588V-X)

- Insolvency is when a company is unable to pay debts as they become due and payable (s95A)

State: s588G imposes a duty on directors to ensure that the company does not trade whilst insolvent. If the elements of s588G are made out, directors can be personally liable for the debts of the company.

State: “ ____ (creditor) will argue liability should be imposed on (director/holding company) because the company traded whilst insolvent).

S588G TEST: Director's duty to prevent insolvent trading by Co

(1) This section applies if:

- (a) a person is a **director** of a Co at the time when the **Co incurs a debt**; and
- (b) the Co is **insolvent** at that time, or becomes insolvent by incurring that debt, and
- (c) at that time, there are **reasonable grounds for suspecting** that the Co is insolvent, or would so become insolvent, as the case may be; [**objective test**] and

(1A) For the purposes of this section, if a Co takes action set out in column 2 of the following table, it incurs a debt at the time set out in column 3. [*see below*]

(2) By failing to prevent the Co from incurring the debt, the person **contravenes** this section if [*civil liability*]:

- (a) **the person is aware** at that time that there are such grounds for so suspecting [**subjective test**]; or
- (b) **a reasonable person** in a like position in a Co in the Co's circumstances would be so aware [**objective test**].

Note: This subsection is a civil penalty provision (see subsection 1317E(1)).

(3) A person commits **an offence** if [*criminal offence*]:

- (a) a Co incurs a debt at a particular time; and
- (aa) at that time, a person is a director of the Co; and
- (b) the Co is insolvent at that time, or becomes insolvent by incurring that debt, or by incurring at that time debts including that debt; and
- (c) the person suspected at the time when the Co incurred the debt that the Co was insolvent or would become insolvent as a result of incurring that debt or other debts (as in paragraph (1)(b)); and
- (d) the person's failure to prevent the Co incurring the debt was **dishonest**.

Proving Insolvency

State: “The following 3 elements in s588G must be proved to establish this duty”

(a) A person is a director of a company at the time when company incurs a debt

State: "A person is a director of a company at the time when the company incurs a debt if they are a:

- De jure director (s9(a)(i))
- De facto direction (s9(b)(i))
- A shadow director (s9(b)(ii)) (Person who acting as director though not formally appointed (*Standard*)).

(b) The company is insolvent at that time, or becomes insolvent by incurring that debt

- A company incurs a debt when it subjects itself to an unavoidable obligation to pay a sum of money at a future time (*Bank of China*)
- This does not depend on a strict legal analysis but on substance of arrangement and commercial reality (*Plymin*).

(c) At that time, there are reasonable grounds for suspecting that the company is insolvent, or would become insolvent

- The courts, in looking at all of the company's circumstances, draw a distinction between a temporary lack of liquidity and an endemic shortage of working capital: *Hall v Poolman*
- What is reasonable grounds? Whether a reasonable person in the same position as the director looking what was apparent would have suspected the company's solvency: *Plymin*

Consider:

- Whether the Co has more assets than liabilities
- What cash resources the Co has
- The capacity of the Co to pay debts to meet debt payments by raising share capital, by borrowing or by mortgaging assets within a reasonable period

HD Point: in *ASIC v Plymin*, the non-payment of debts by a Waterwheels did not necessarily indicate insolvency, but the size of some of the debts, and delay in their payment was sufficient to justify the inference that W was insolvent.

Rebuttal presumptions of insolvency

State: "Company will presumed to be insolvent if under s588E(3)

- (a) the Company is being wound up and
- (b) during the whole 12 months prior to commencement of its winding up it is proved that it was insolvent at any time during those 12 months.

Conclude: "Prima facie, _____ has breached their duty to prevent insolvent trading"

S588G(2)

State: “By failing to prevent the company from incurring the debt _____ contravenes s588G(2) if:

- (a) director is aware at that time there were grounds for suspecting insolvency or
- (b) a reasonable person in a like position would be aware (objective)

S588G(3)

State: “A breach of s588G(2) constitutes an offence if the directors failure to prevent the company incurring debt was dishonest”

Conclude: “Prima facie, _____ has/has not breached his duty to prevent insolvent trading”

Defences to Insolvent Trading

1. Expectation of solvency (s588H(2))

State: “ _____ (dir) will argue he is not liable under s588G(2) if it is proved under s588H(2) that _____ (dir)”:

- had reasonable grounds to expect, [*objective test*] and did expect that the Co was solvent at that time and would remain solvent even if it incurred that debt and any other debts that it incurred at that time.
- Reasonable grounds for expecting solvency means a higher degree of certainty than ‘mere hope or possibility’ or suspecting: *Hall v Poolman*
- Hard to make out b/c it must already have been shown under s588G(1)(c) that there were reasonable grounds for suspecting that the co was or would become insolvent.

2. Reasonable reliance on info given by another (s588H(3))

State: “ _____ (dir) will argue _____ (he/she) is not liable under s588G(2) if it is proved under s588H(3) that”:

(a) _____ (director) had reasonable grounds to believe, and did believe:

- (i)** that a competent and reliable person [X] was responsible for providing [dir] adequate info about whether the Co was solvent; and
- (ii)** [X] was fulfilling that responsibility; and

(b) _____ [dir] expected, on the basis of info provided, that the Co was solvent

Note: A dir cannot rely on s588H(3) if he fails to demand info which would raise suspicions about the co’s solvency if he or she had looked at the information. **Can’t argue**

ignorance: *Plymin.*

3. Illness or other good reason (s588G(4))

State: “ ___ (*dir*) will argue he is not liable under **s588G(2)** if it is proved under **s588H(4)** that:”

b/c of **illness** or for some other good reason, he did not take part at that time in the management of the Co.

4. All reasonable steps taken (s588H(5), s588H(6))

1st State: “ ___ (*dir*) will argue he is not liable under **s588G(2)** b/c under **s588H(5)** he took **all reasonable steps** to prevent ___ (*Co*) from incurring the debt.”

- It is suggested **strong actions** are needed to use his powers to stop debt being incurred or they must bring it to the attention of a director who can prevent it or to the attention of the BOD.
- It's not enough to express reservations
- Not much case law on this section.

2nd State: “When determining whether ‘reasonable steps’ in **s588H(5)** have been taken, **court must consider** factors in **s588H(6)**”:

(a) **any action** the person took with a view to appointing an administrator of the Co; **and**

(b) **when** that action was taken; **and**

(c) the **results** of that action.

→ must be very prompt action taken by director.

HD Point: in *ASIC v Plymin* administrator was appointed 5-6 months after insolvency date, so not valid.

Conclude: “ ___ (*dir*) ___ (*will/will not*) be able to rely on a defence and thus, ___ (*has/has not*) breached his/her duty to prevent insolvent trading.”

CONSEQUENCES OF BREACH

- Breach of **s588G(2)** = a breach of civil penalty provisions: **s1317(1)**
- Liable to pay compensation: **s588J** or **s588M(3)**;
- Breach of duty of care & diligence in **s180(1)** and duty of care, skill and diligence at CL