

General Knowledge

What is company law? Legal rules governing:

- Formation and termination of companies
- Characteristics of companies (proprietary, limited, listed, big/small etc.)
- Relationships between participants in companies: Directors, officers, shareholders, creditors
- Companies' dealings with outsiders (involuntary and voluntary say via a contract)

Aims/purposes include: Provides a degree of certainty

- Investor protection (you know what your rights are – when you buy shares or lend)
- Commercial stability and consumer confidence (what rights and liabilities are)
- Balancing competing interests (different for shareholders, customers, employees etc)
- Certainty - standard form rules (although these can be tailored according to the company's circumstances)

Sources of rules

- **Corporations Act 2001:** 'legislation', 'statute': Act is a piece of legislation, it is what the parliament of Australia has passed (agreed upon)
- **Case law:** Precedents (law judges make; body of legal principles reinforced by case decisions; how the act is interpreted + actual legal rules)
- **Other sources:** Corporations Regulations, ASIC Act, ASIC exemptions, accounting standards, ASX Listing Rules

Operation of company law

Private law: that decides disputes between (one citizen can use against the other)

- Shareholders vs the company (can sue)
- The company vs shareholders (can sue)

Public law: that allows ASIC to punish wrongdoers and seek compensation for the company

Dictionary Δ

Appoints a receiver: To take possession of and liquidate the assets secured by the security agreement in order to repay the outstanding debt

Dividend imputation: Tax the company pays on its profits is imputed to the shareholders who receives the dividend, which is then accredited against their own tax bills - when company tax rate is lowered the more tax shareholders pay

Litigation: The process of taking legal action.

Secretary: (lawyer - record-keeping)

Executive: (manage) vs. **non-executive directors** (to supervise and give advice from experience)

Officers: (senior management, not part of the board but play significant degree of influence over the affairs of the company— s 9 (includes a director, but director doesn't include an officers)

Expropriation: (of the state or an authority) take (property) from its owner for public use or benefit.

Unanimously: without opposition; with the agreement of all people involved

An objects clause: is a provision in a company's constitution stating the purpose and range of activities for which the company is carried on.

Ratifying: sign or give formal consent to (a treaty, contract, or agreement), making it officially valid.

Discretion: the quality of behaving or speaking in such a way as to avoid causing offence or revealing confidential information

Fiduciary: involving trust

Insolvent: unable to pay debt owed

Voluntary Administration: is a process where an insolvent company is placed in the hands of an independent person who can assess all the options available, and generate the best outcome for a business owner and for creditors.

Hostile takeover: Is where a company offers the shareholders a higher share price for its shares in order to gain controlling interest

An offer: each shareholder has the choice of accepting or refusing

Minimum holding buy-back: Odd lot/unmarketable parcel of shares (too small to sell) – company buys them back

Employee share scheme: Keep employees motivated, the company buys back them when they resign

Within (over) 10/12: The company is buying back 10% or less (over 10%) of the total shares purchased within the 12 month period

Min 14 days notice to ASIC before the buy-back

On-market buyback: Proposing to buy-back shares to anyone who wants to sell it to the company

Equal-access scheme: Buy-back the same percentage of everyone's shares

Choice of form of business

Unincorporated entities: have no legal personality separate from their participants' e.g. sole traders, clubs, partnerships (can be sued personally; if the partner gets sued – all partners have to pay)

Incorporated entities: ('corporations', 'companies') are separate legal persons – [under the Corporations Act 2001 \(Cth\)](#)

- Incorporated Association: e.g. UMSU, under the Associations Incorporation Act (having office bearers – like a company's directors) – separate legal entity
- Not all not-for-profit entities are associations. Some are registered companies or other types of corporations

Choosing a company

Advantages:

- Can have more than 20 members (large partnerships prohibited by [s 115](#)) (restrictions reflects the unlimited liability of each of the partners, as it is a relationship of mutual trust and confidence) (There are restrictions within the types of companies, incorporation is the biggest)
- May have limited liability for its shareholders
- May be easier to raise capital (Partnerships cannot raise capital beyond the partners; Public companies can only raise equity capital)
- Different tax treatment – dividend imputation (profits are only taxed once)
- Company law as standard form contract (big body of rules, we all know where we stand)
- Flexibility (can have small or big company)
- Perpetual succession

Disadvantages:

- Usually greater expense in formation and compliance (Partnerships can be formed on the spot; this could also be a disadvantage as partnerships can be imposed upon by conduct) (Companies have to fill forms, pick names and pay fees etc.)
- May have to reveal information to the public (Companies have annual requirements) (the smaller the company the less you have to reveal) (Publicly listed companies are under duty of continuous disclosure)

The decision must always depend on the individual circumstances of the business

Companies

Introduction to companies

- The dominant form of business organisation (because personal belongings is protected when company is bankrupt/sued)
- Traditionally used to bring people and capital together to run a business (synergy)

Capital structure[↑]

Equity capital: Contributed to the company by shareholders

- Shareholders called 'members' in the Act – 'owners' of company
- Equity is generally not repaid (share buyback) during life of the company

Debt capital: Owed by the company to 'creditors': Employees, suppliers, lenders (lenders: banks or shareholders/directors)

- **Can be 'secured' debt:** Mortgage etc. (the security holder appoints a receiver^Δ and seizes the property and sells it, in the event a company cannot pay)
- Debts must be paid whether company is profitable or not
- If company can't pay debts, it becomes insolvent and is liquidated

(1) Secured creditors (e.g. banks) **(2)** priority creditors (e.g. employees) **(3)** unsecured creditors (e.g. ordinary suppliers) **(4)** shareholders last.

Tension between equity and debt – debt can collapse the company but equity can upset the balance of power

Registering Companies: Companies created through registration by ASIC

Procedure in s 117; ASIC Form 201 (or acquiring an already registered company (shelf companies – registered for the sole purpose of being on-sold and not traded prior to sale))

Establish a name that no one else has used – s 148(1), and after the name you have the following letters: – s 148(2)(3)(4)(5)

- Member approval required to change the company's name: s 157 (75%)
- Member approval required to change type (e.g. from proprietary to public): s162 (75%)

Separate legal entity doctrine

The company is a separate legal person - an 'artificial legal person' whilst humans are 'natural legal persons'

Companies can legally do most things that humans can do, and some extras e.g. issue shares to raise share capital s124

- Company can incur obligations and hold rights, and sue and be sued, in its own name
- Company can contract with its controllers and others[↑]: **Lee v Lee's Air Farming Ltd**
- Company has 'perpetual succession'
- Company is a separate taxpayer (Dividend imputation)^Δ

Cases: Salomon v Salomon & Co Ltd; Macaura v Northern Assurance Co Ltd

'Piercing the corporate veil': Body of law that disregards the veil of incorporation (will allow in limited circumstances, the separate legal entity doctrine to be disregarded and the shareholders to be liable for corporate debts)

- Shareholders normally don't have to pay company debts (they are separate entities)

- The court will not allow someone who has deliberately set up a company to avoid a legal obligation

Cases: **Gilford Motor Company Co Ltd v Horne; Jones v Lipman**

Corporate groups: Companies can be shareholders in other companies

Often different aspects of the business are owned or carried out by different companies in a group

- Each business has its own debts quarantined in the business

“The **holding company** has the legal right to control the votes of the **subsidiary** such that it can control the appointment of directors to the subsidiary board and therefore is in a position to tell the subsidiary what to do” (Holding company has 50% or more of the voting shares of the subsidiary) (**s 46**)

A subsidiary is also a **related body corporate** of all other subsidiaries of its holding company (**s 50**)

Control: ‘An entity controls a second entity if the first entity has the capacity to determine the outcome of decisions about the second entity’s financial or operating policies.’ – **s 50AA (capacity to influence)**

- All subsidiaries are entities controlled by their parent company (**capacity to influence and 50% of shares**)
- **Controlled entities:** A company could be controlled by another company without being its subsidiary. (**just capacity to influence**)

Different provisions of the CA applying to Holding and Subsidiary vs. controlled and controlling
Law treats holding and subsidiaries and controlled and controlling entities as separate entities with a few exceptions – piercing the corporate veil

Single director/shareholder companies: Special type of company in which the only member is also the only director

Only allowed for proprietary companies (as public companies must have at least 3 directors)

RRs do not apply: s 135(1)

Some special rules apply – **s 198E** (powers), **201F** (appointment of directors) and **202C** (remuneration)

Types of Companies[↑]: Companies are classified by reference to basis and extent of the members’ liability – **s112**

Limited Liability Company/ Company limited by shares (Pty or public)

1. This company has share capital
2. A member’s liability to pay the debts of the company is limited to the amount (if any) unpaid on their shares: **s 516**
 - If shares are fully paid for, no further contribution required
 - Company may issue shares that are partly paid: Shareholder is obliged to contribute further if a “call” is made on partly paid shares
 - If call is not paid, shares may be forfeited (but the amount is still owed): s 254M(1)

The liability of the company is not limited, the shareholders liability is limited (The company’s debts have to be paid by the company, not its shareholders (separate legal entity))

Company limited by guarantee (public only):

1. This company does not have share capital

2. e.g. club/charity that wants the benefit of incorporation (liability to its members to the respective amounts that the members guarantee to contribute to the property of the company if it is wound up)

Unlimited company with share capital (pty or public):

1. (some companies like accountants and lawyers cannot run a limited liability company due to professional rules of that profession, but is a company because of the need for separate legal entity with perpetual succession for other contracts)
2. No letters after the company name (as you don't need to warn anyone)

No liability company (NL) (public only): Only mining companies – recognises the extreme risk involved (partly paid, but do not have to fully pay) (public because they must provide information)

Some provisions of the Corporations Act apply only to certain types of companies

Proprietary Companies – Pty Ltd[↑] - s 113:

1. No more than 50 non-employee members (less compliance obligations (more privacy)– thus small enough to be close to management) (unlimited employees because they know the company)
2. No fundraising activity requiring a disclosure document under Chapter 6D (cannot get 50 shareholders via issuing a prospectus – not offering shares to strangers) – s113(3)
3. Must have at least 1 directors – s 201A(1)
4. More flexibility (More adaptable, esp. with RR)

Public Companies[↑] - Ltd

Everything other than proprietary companies: s 112

1. Allowed to have an unlimited number of shareholders (minimum of 1; thus public scrutiny and investor protection is needed)
2. Can raise funds from 'the public' (thus subject to stricter rules)
3. Must have three or more directors: s 201A(2)
4. More rigid; Aim is greater shareholder protection through transparency and accountability
5. More procedures e.g. compulsory annual general meetings
6. More publicity e.g. published financial statements

Public Listed Companies

Are listed on a securities exchange – ASX, Chi-X etc

Follow ASX Listing Rules

Shares and Rights

What are shares?

- Claims against a company to which 'rights' attach
- **Shares are valuable assets that can be sold by the shareholder**
- Companies can be shareholders in other companies – this entitles them to shareholder rights and remedies

Classes of shares: Shares can be created with different rights attaching, called 'class rights'

- **contained in the company's internal documents that includes the terms of the share issue: s 254B**

- Dividends 'rights' (under director's discretion - does not have to be paid)
- Voting rights (sometimes you cannot vote – e.g. preference shares)
- Rights and priorities in repayment of capital or surplus on winding up (solvent)

Directors have power to issue shares (**RR s198A**) but the issue of shares may require shareholder approval in some circumstances

Preference shares:

A company can issue only if rights attached are set out in the constitution (if any) or have been otherwise approved by special resolution of the company (recorded in minutes – **used oppression remedy if breached**)

Preference shares usually carry rights to: **s 254A (2)**

- Cumulative and non-cumulative dividends
- Priority for repayment of capital
- But limited voting right
- No right to share in surplus on winding up

Variation of class rights

What is a variation of class rights? 2 shareholders with 1 vote each; the other shareholder is given 10 votes per share. Their class rights have been varied. However your class right is not varied despite power being diluted

General case law test is narrow – effect on enjoyment is not enough; strict legal rights must be varied *Greenhalgh v Arderne Cinemas; White v Bristol Aeroplane*

However, **the Act** adds to general law by deeming some other actions to be variations

Deemed variation of class rights

Section 246C: certain actions will amount to variation of class rights

- **Splitting a class into two – s 246C(1)**[↑]

(E.g. 1 class of ordinary shares, divided into A (10 votes/share) and B (1 vote/share) – Vary the rights of every share)

- **Varying the rights of some members only – s 246C(2)**

(E.g. 1 class of ordinary shares, Fred has special rights to his shares – deems every rights to varied)

- **Issuing new shares (new class) where only one class at present – s 246C(5)**

(E.g. Ordinary shares, issues preference shares (rights not the same as ord.), taken to vary the rights of ordinary shares unless the company's constitution has provided for the rights or a document has been lodged with ASIC)

(E.g. Ordinary A and Ordinary B, issues preference shares, **not taken to vary the rights of ordinary shares**)

- **New preference shares ranking equally – s 246C(6)**[↑]

(E.g. new preference shares that rank equally with existing preference shares – **existing preference shares varied** unless the issue is authorised by the terms of issue of existing preference shares or the company's constitution as in force when the existing preference shares were issued)

(E.g. issuing new preference shares with better rights than the existing, **it is not deemed varied** – rank them ahead)

Variation or cancellation permitted only:

- **Section 246B(1)**: In accordance with the procedure set out in the constitution, or
- **Section 246B(2)**[↑]: Where the constitution is silent about a variation procedure, by special resolution (75%) of the company and a separate special resolution of each of the classes whose rights have been varied (including preference shareholders)

If procedure not followed, then the rights are not varied.

What if the company acts as though the rights were varied: e.g. won't let you vote; won't pay your dividend? **Use the oppression remedy**

What if members aren't happy with the variation?

Only applies where the procedures are followed s246B and a shareholder is unhappy with the result – i.e. outvoted!

(Member statutory remedy) Section 246D: rights of dissenting members where the variation, cancellation or modification does not have unanimous consent.

- Members holding at least 10% of the class can apply to the Court for change to be set aside for **unfair prejudice (upper limit is 25% as 26% of the shares would've just voted against it)**
- What if you hold less than 10%? Consider the oppression remedy

Increasing share capital

Process of share issue

- generally, a decision of the board: **RR s 198A**
- directors must exercise their share issue power for a proper purpose (subject to directors duty)

Types of share issues:

1. **Initial public offering (IPOs):** (listed public)
2. **Private placements:** (major shareholders, without prospectus)
3. **Rights issues:** (right to take up more shares at a discount)
4. **Dividend reinvestment plan (DRPs):** (right to take up a shares instead of dividend) and
5. **Bonus issues:** (obligation to take up share instead of dividend)

However, some restrictions on directors' and companies' powers exist

Member approval may be required in special circumstances - See Page 426

Disclosure under Chapter 6D

Unless exclusion in **s 708** applies, a product disclosure statement (PDS) (prospectus or OIS) must be prepared and lodged with ASIC (if there is to be an offer of shares to the public)

- Mandatory disclosure about the company, the offer and the shares

Not all issues – list of exemptions under s 708 (increase shareholding without a prospectus)

- Personal offers to <20 investors and <\$2 million in 12 months – **s 708(1)**
- Sophisticated investors: **s 708(8)** min \$500K
- 'Rich' investors – controlling GA>\$10million – **s 708(11)**

These offers can be made to potential shareholders of Pty Ltd companies

Share issue restrictions for Pty Ltd companies

Pre-emption clauses – s254D ([RR] for Pty Ltd companies – ensures control): When issuing more shares, it must be offered to existing shareholders in that class first

- Issue a second class of ordinary shares will get you around the pre-emption rule, but it is a **variation of class rights**
- **S254D(4):** The company may by resolution authorise directors to make an issue of shares without complying with the pre-emption rule

Pty Ltd companies don't exceed the max. 50 non-employee shareholders – **s 113(1)**

Proprietary companies cannot offer shares in circumstances requiring Chapter 6D disclosure – s 113(3)

Maintenance of capital

General principle: A company must maintain its paid up share capital - rule in *Trevor v Whitworth*

Now represented by Chapter 2J (enforces the Trevor v Whitworth rule)

1. Company providing **financial assistance** to someone else to buy shares in the company
2. **Share buy-backs which are permitted:** and all the conditions under which they have to take place
3. **Self-acquisition:** Whether a company can acquire its own shares
4. **Reductions of capital:** Whether a company can reduce its share capital in some other way

Part 21.3 only allows [a company to “financially assist” the acquisition of shares in the company or its holding company if: s260A](#)

(a) it does not materially prejudice the interests of the company **or** its shareholders **or** its ability to pay its creditors **OR**

(b) it is approved by shareholders (s 260B) **OR**

(If a company does give financial assistance and materially prejudice those above, but has shareholder approval, it does not breach s260A on part of the company, but it would be a breach of directors’ duty by the directors and managers – s181)

(c) it is exempt under s260C

Examples of financial assistance:

- Giving a loan
- Giving a guarantee

Material prejudice: Question of fact to be determined in light of the circumstances: *ASIC v Adler* (Under **DIRECTOR’S DUTIES**)

Breach of s260D

Contravention by company but no penalty for company and transaction is still valid (both financial assistance and share purchase) (we want to protect shareholders, valid because innocent people are involved)

- **Persons involved liable for civil penalty:** directors, officers, managers, anyone etc.
- **Also criminal consequences if dishonesty**

Permitted buy-backs: s 257A – 257J

Company can buy-back its own shares in certain circumstances

- **s 257A(a):** ALL buybacks must not materially prejudice the company's ability to pay its creditors, **AND**
- **s 257A(b):** The Acts procedures must be followed, depending on the type of buyback -s257B
 - **Selective buy-back:** is when the company does not make identical offers to every shareholder. For instance, the price or percentage of share bought back differs for some shareholders.– s257D has to be applied

Buy back approval rules

S 257C: ordinary resolutions if **section 275B** applies for when the 10/12 limit is exceeded (under 10/12 not needed)

S 257D: selective buyback approvals

(a) Special resolution - with no votes cast in favour by those whose shares are being bought back (those selected or their associates (Family members, partners etc) are not allowed to vote)

- Those who can vote = 100% - need $\frac{3}{4}$ of those

Protection of those ‘left behind’ in the company, as capital is returned

(b) **OR** Unanimous resolution **at the general meeting** by all ordinary shareholders (as can be left with no one with the right to vote if part are selected and the others are their associates)

Self-acquisition: S 259A prohibits a company acquiring shares in itself

So failure to do a share buyback properly under s 257A is a breach of 259A

Breach of s249A - 259F

Contravention by company but no penalty for company and transaction is still valid (both financial assistance and share purchase) (we want to protect shareholders, valid because innocent people are involved)

- **Persons involved liable for civil penalty:** directors, officers, managers, anyone etc.
- **Also criminal consequences if dishonesty**

Does not extend to redeemable preference shares: **Part 2H.2** (shares bought back at a future date)

Permitted reductions of capital: s 256B – s 256E

Reductions of capital may be made to return excess capital, cancel uncalled capital, or cancel capital no longer represented by assets (assets = capital – accumulated losses)

- **Not an offer – it is binding on the shareholders**

If procedure is followed properly, there is no **Gambotto equitable limitation remedy** – that case only deals with amendments to company's constitution to insert a clause allowing expropriation of shares (The reason is that the statutory requirements provide protection to minority shareholders)

- CA allows shares of minority shareholders to be expropriated in the context of a selective capital reduction provided the procedures specified in the CA are followed. *Winpar Holdings v Goldfields Kalgoorlie*

Company may reduce its capital provided it is: - S256B

- (a) Fair and reasonable to the shareholders as a whole AND
 - (b) Does not materially prejudice the company's ability to pay its creditors, AND
 - (c) Approved by shareholders: s 256C
 - (a) If the reduction is an equal reduction, it must be approved by **ordinary resolution**
 - (b) If the reduction is a selective reduction, it must be approved by either a special resolution - with those selected or their associates **OR** those whose liability are reduced not being able to vote
- OR Unanimous resolution** at a general meeting by all ordinary shareholders
- **Under (b) in CA:** If the reduction involves the cancellation of shares, (lose power) the reduction must also be approved by a special resolution passed at a meeting of the shareholders whose shares are to be cancelled (in addition to either a or b)

Minority still unhappy? Oppression?

Internal Governance Rules

If the question says the company only operates under the replaceable rules, there is no constitution

Internal governance rules: Every company can decide how to manage their internal workings, with some limits (enforceable internally, but not in a public way; rules cannot override the CA, however occasionally the act will say 'subject to the company's constitution, where you don't have to follow a CA rule)

Found in - Corporations Act s 134:

- **The 'replaceable rules' [RR]:** (The Act provides a set of internal governance rules to help and you can replace them) and/or
- **The company's own constitution:** (can write a constitution that has all the internal gov. rules),

RRs apply unless they are displaced or modified by a constitution – s 135(2)

Replaceable rules (RRs)

Companies formed prior to 1 July 1998 (when the RR was introduced) may still have their old memorandum (like ASIC application) and articles of association (equivalent of RR) (all of which are required under the old law)

- Many companies used "Table A" (RR as they are called now) (they were at the back of the Act) –Presently, table A is their written constitution (and can be replaced with RR if they like)
- RR now are scattered throughout the act and listed in **s141**

Adopting a constitution: Can be done when the company is registered, or later: **s 136(1)**

Remember: If the company runs on replaceable rules, that means the company does not have a constitution and therefore need to adopt terms - **s136(1)b**

- Adopting, amending or repealing a constitution after registration **requires a special resolution of members: s136(2)**
- **↑ Special resolution – s 9:** 75% vote of those present (inc. Proxys) who are entitled to vote (not preference shareholders) (26% is a vote that can block a special resolution)
 - **Entrenching a rule:** constitution can contain extra requirements for changing its rules: **s 136(3)**

This entrenching clause can only be changed: If it is itself **complied** with e.g. a larger % required, or approval of a particular person: **s136(4)**

Legal effect of the internal governance rules[↑]

Section 140: A company's constitution (if any) and the RRs that apply to it have effect **as a contract** between:

- (a) the company and each member
- (b) the company and each director and secretary
- (c) a member and each other member

Case: Eley v Positive Government Security Life Assurance Co Ltd

s 135(3): A failure to comply with the RR is **not a breach of the act – ASIC DOES NOT GET INVOLVED**

Failure to comply with RR is a **breach of contract:** So use contract law rules for interpretation and remedies (e.g. To enforce a contract you need to be a named party)

↑ **Oppression** (can use this remedy if you are treated unfairly) – s 232 to s 234 (third party of the contract)

Procedural irregularity: May still be valid if the company doesn't follow the constitution in a small, technical way (MEMBERS MEETINGS)

Equitable Limitation/Gambotto

Members may exercise voting rights in their own self-interest

But there are limits – **called 'the equitable limitation'**

- To stop unfair exploitation of minority shareholders by majority
- Because it is not always possible for minority shareholders to sell and get out of the company (especially ptys)

It is a duty on the **majority to not deliberately harm the minority**

The rule applies slightly differently for:

1. **Cases not involving constitutional amendment: Breach of equitable limitation**
 - Majority unwilling to bring legal action and majority are alleged wrongdoers: *Biala v Mallina Holdings*
 - Majority must not exercise their vote so as to give themselves 'property, advantages or rights which belong to the company' *Menier v Hooper's Telegraph Works*
2. **Cases involving changing the constitution:** Even where s 136 is complied with, amendment may be invalid due to equitable limitation

Gambotto v WCP Ltd establishes different tests for different amendments

Category 1 amendments↑: Amendments to allow expropriation^Δ of

- minority's shares; or
- valuable proprietary rights attached to their shares (e.g. voting or dividend rights)

These changes to the constitution are only valid if:

1. Done for proper purpose, and
2. No oppression of minority shareholders (**oppression remedy if proposed**)

The only "proper purpose" recognised by the court is to prevent harm to company, e.g.:

- minority s/h is competing with company
- removal of member is necessary to allow company to continue in present business

Advancing company's commercial interests is not enough

Also must show that there was no oppression. This requires:

- **Procedural fairness:** full disclosure and independent valuation of the shares to be expropriated
- **Substantive fairness:** price paid for the expropriated shares is fair (may not always be market value)

Category 2 amendments: Other constitutional amendments involving a conflict of interest between shareholders

Changes to the constitution are only valid if:

1. Done for a company purpose, (More "purposes" are valid here compared with Category 1 including advancing the overall commercial interests of the company), and
- No oppression of minority shareholders (the amendment is procedurally and substantively fair in all the circumstances)