

TABL2741- Business Entities Notes

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Lecture 5- Internal Governance and Corporate Liabilities

<p>1. Understand the source of internal governance rules of a company</p>	<p>Prior to 1998- company had 2 documents</p> <ul style="list-style-type: none">• Memorandum of association and articles of association- the incorporation document. Contained basics of company e.g. capital structure, objective of the business (called the objects clause), nature of members liability<ul style="list-style-type: none">- Also included internal governance rules- Objects clause caused issues- if the company contracted outside of this clause, the contract could be invalid (called ultra vires- operating outside the entity). Issue removed by corporation's act as the company can contract as though an individual <p>Post 1998 reforms companies could choose to have internal management rules in</p> <ul style="list-style-type: none">• Replaceable rules within Corporations Act (usually done by small proprietary companies)• Draft a constitution in a single document• Have a combination of both <p>A one person company will usually make their own rules because rules aren't designed for these companies</p> <p>Public companies are required to lodge their constitution with the ASX. ASIC can request a copy from proprietary companies</p> <p>s140 states a company must comply with either the replaceable rules, company constitution or a combination of the two.</p>
<p>2. Understand the relationship between the company's constitution and replaceable rules</p>	<p>There are 39 replaceable rules. S141 has a table of summary for the rules found in various sections of the constitution e.g.</p> <ul style="list-style-type: none">• Appointment and removal of the directors (s210G and 203C)• Powers of the directors (s198A)• Inspection of books (s247D)• Directors meetings (248A-G) <p>A major benefit is the rules are kept up to date with statutory change → saves company from putting out an amendment.</p>

	<p>However- major shortfall is there is a bias towards proprietary company (thought public company is big enough to make a constitution)</p> <ul style="list-style-type: none"> • There is a rule that's mandatory for public and not pty co – has to do with electing a proxy <p>If a combination of RR and constitution is used, there is the effect of a contract binding all of its members (s140). Contract can be enforced:</p> <ul style="list-style-type: none"> • By the company against its members • By an officer against the company • By members against themselves <p>Significance:</p> <ul style="list-style-type: none"> • Will contain distribution of powers between members, directors and the company. • S198A is a commonly accepted rule allowing the company's managerial authority to be given to a board of directors •
<p>3. Explain the legal nature of a company's constitution and replaceable rules</p>	<p>The rules in the constitution must be followed and can be enforceable by the court. Hickman v Kent or Romney Marsh Sheepbreeder's association</p> <ul style="list-style-type: none"> • Company had the rule that a dispute between a member and the company must go through arbitration before going to court • Hickman attempted to sue after being expelled from the company • Court found the matter must go through arbitration before seen by the court <p>The fact that there is a contract allows more rights and remedies for members e.g. injunctions: Andrews V Queensland Racing Ltd.</p> <p>Anyone not specified in the constitution is not bound by the constitution- Forbes v NSW Trotting Club</p>
<p>4. Explain the manner in which the constitution/rules can be changed</p>	<p>Altering the constitution requires a special resolution (s136) → a majority vote of 75%</p> <ul style="list-style-type: none"> • To protect minority shareholders, changes are subject to limitations from statute and general law e.g.

	<ul style="list-style-type: none"> - Statutory- - S140(2) members written agreement is needed to take up extra shares or increase their liability to capital contribution - S264B- procedures apply to vary/cancel rights attached to shares - S232-234 protects minority shareholders against oppressive or unfairly discriminatory acts - Equity- - Gambotto v WCP → must have proper purpose and be fair in circumstances. for wanting the amendment. Here found that saving money was not enough for a compulsory acquisition of shares -
<p>5. Explain the contractual capacity of companies- full or limited</p>	<p>A company is a legal abstraction and needs people to operate on its behalf. This extends to going into contracts.</p> <p>S198- gives directors the power to manage a company and to delegate powers (most constitutions will have something similar)</p> <p>A company can be liable in 2 ways:</p> <ul style="list-style-type: none"> • Primary liability <ul style="list-style-type: none"> - Company is liable when its committed a wrong itself through a controller and director - Organic theory- if someone can act as the mind of the company then they can contract through the company with primary liability (e.g. a director) → H L Bolton Engineering Company v T J Graham and sons - E.g. Lennard’s Carrying Co v Asiatic Petroleum Co- the actions of Mr Lennard caused Asiatic to loose cargo on Lennard’s ship. Lennard argued that the actions of Lennard aren’t the actions of the company. BUT Lennard was a director, so they were the actions of the company and therefore could be liable

	<ul style="list-style-type: none"> • Secondary liability <ul style="list-style-type: none"> - When a company is made liable for the acts or omissions of a natural person (vicarious liability) - Hollis v Vabu- One of vabu's /ees left a bike where it injured Hollis. Hollis said vicarious liability applies. Vabu said that the delivery bikers were contractors not /ees. Court found they're /ee therefore, liability is to with the company <p>A company can contract using a common seal (not compulsory). Or it can contract with the witness of:</p> <ul style="list-style-type: none"> • 2 directors OR • A director and a company secretary OR • If it's a pty/sole trader, the director <p>These are the same ways a company can execute a document</p>
<p>6. Explain the authority of a company's officer and agent to contract</p>	<p>A company is legally bound by a contract made on its behalf by an agent with authority. An agent can have actual authority or apparent authority</p> <ul style="list-style-type: none"> • Actual authority- can be expressed or implied. • Apparent authority- has 3 criteria Freeman and Lockyer v Bathurst Park Properties <ol style="list-style-type: none"> 1. The agent has represented themselves as having authority to enter a contract as the company 2. The representation was made by someone with authority to manage the company 3. The contracting party relied on this representation to enter the contract • Northside case found a director doesn't have apparent authority to act on behalf of company- only there to act as part of the board • Panorama Developments case- a company secretary has implied authority to manage the administrative affairs of the company NOT the business affairs
<p>7. Explain the manner in which companies can be liable in contracts</p>	<p>When a contract is found defective, the company is liable if:</p> <ul style="list-style-type: none"> • Indoor management rule (Turquarnds case) is applied - Royal British Bank v Turquand - The company had a clause saying loans must be approved by shareholders. Directors took out a loan without approval and defaulted. When company sued, they said the directors didn't have the power to do so. The court said they still had to pay.

- Gave rise to the following assumptions allowed by someone going into contract with the company
 - There were no procedural defects in appointment of directors
 - A board meeting has been properly called and held
 - Any board or general meeting approval required has been obtained
 - i.e. have the assumption that internal procedures have been properly carried out
- Gives protection to lenders and contractors

Other assumptions under s129 include:

- Acts of indoor management are complied with
- Officer/agent held out as authority
- Documents are validly executed if signed/witnessed
- Documents are genuine when claimed to be so by company officer/agent

Limitations to the rule (Northside case)

- Actual knowledge that the company hasn't followed internal procedures
- Put on inquiry exception- the outsider failed to make inquiries which were usual to do so in their role OR
 - A reasonable person would have been put on inquiry about irregularities in the situation but the person didn't

Limitations under s128

- Had actual knowledge on the contrary
- They suspect that the assumptions are incorrect (similar to put on inquiry)

Northside case

- N was a passive investment company
- Director and his son as secretary got a mortgage for a company that the director owned putting northside as the collateral
- The other company failed → bank sought collateral from northside
- The court found they didn't have to pay because:

	<ul style="list-style-type: none"> - A person should have questioned when the director and his son signed - Should have questioned why a passive investment company was backing the loan
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Lecture 6- Promoters, Corporate fundraising and Debentures

<p>1. Define a promoter</p>	<p>Not defined in Corporations Act- Whaley Bridge Calico Printing v Green and Smith (1879)</p> <ul style="list-style-type: none"> • “Summing up in a word a number of business operations familiar to the commercial world by which a company is generally brought into existence” • Essentially someone involved in the setting up of a company • Deliberate flexibility to capture a wide range of people within the law on promoters • Professionals e.g. accountants and lawyers are typically exempt from concept if acting in their professional role <p>Typical activities include:</p> <ul style="list-style-type: none"> • Negotiating of preliminary contracts • Preparing of the company’s constitution • Identifying prospective directors and shareholders
<p>2. Discuss promoter’s duties and liabilities at common law</p>	<p>They have a fiduciary duty because they control the fate and direction of the company. Aequitas v AEFC 2001</p> <ul style="list-style-type: none"> • Means they must avoid all conflict • Have duty of full disclosure • Erlanger V New Sombrero Phosphate Co- <ul style="list-style-type: none"> - Erlanger created a company with puppet directors and sold land for double the purchase price. He profited in a way that hurt the new company and its shareholders - When taken to court, the purchase price was recovered and land given back to Erlanger as he’d breached his fiduciary duty to the new company as a promoter - Must have full and proper disclosure

	<p>Remedies for breach of duties</p> <ul style="list-style-type: none"> • Rescission of contract- restoring parties to their pre-contractual position (e.g. Erlanger case) <ul style="list-style-type: none"> - Usually occurs when the promotor has personal interest within a company and fails to disclose - Right to rescind may be lost when: <ul style="list-style-type: none"> • impossible to restore parties to original position • there has been undue delay • the contract has been affirmed • innocent third parties have acquired an interest in the property • Rescission of contract and damages- will occur when the promoters misrepresentation to the company is fraudulent • Constructive trust order- when a promoter has acquired property for the company but has retained it for personal gain. The promoter will have to hand over the property for the original purchase price.
<p>3. Explain liability for pre-registration contracts under CA</p>	<p>S131</p> <p>Pre-registration contracts are entered on behalf of the company before it has been formally registered with ASIC</p> <ul style="list-style-type: none"> • Purpose: for time-critical decisions e.g. purchase property to secure premises before interest rises, import raw materials which have become cheaper due to currency movements <p>The company is bound by the contract if</p> <ul style="list-style-type: none"> • it is registered and ratifies (approves) the contract within a reasonable time <p>The promoter is not bound when</p> <ul style="list-style-type: none"> • the company is bound as above • they obtain written release from the other party i.e. supplier • company enters into a new contract to replace the old one → Novation <p>BUT- if there is seen to be an abuse, the court can lift the corporate veil</p> <p>The promoter is bound when:</p> <ul style="list-style-type: none"> • the company is not registered, or the contract is not ratified in the agreed time

4. Discuss fundraising procedures for a public company issuing securities and investor protection methods

There is a need for regulation of fundraising to:

- ensure a fair and well informed market where investors can identify risk
- deter dishonest conduct
- encourage cost effective access to information
 - difficult for retail investors to get information so it needs to be mandatory

Proprietary companies

S113 prohibits Pty companies from engaging in any activities requiring disclosure documents (can do all the below except activities)

- except for issuing shares to existing shareholders and employees
- It's a strict liability offence
- May be required to become a public company

Disclosure documents are needed for any offer of securities unless exempt

Exemptions include (**s708**)

- Small scale exemption- 20 issues in 12 months with max \$2 mill capital raised
- Sophisticated investor exemption- investing min \$500k, investment experience, gross income of min \$250k, assets net 2.5 mill
- Professional investor- manage min 10mill
- Senior manager/relation
- Existing shareholder
- Takeover and scheme- this has its own disclosure requirements
- Exempt bodies and public authorities

Disclosure documents(**s9**)-

- For the protection of investors, the application form is at the back of the document (so they should read it all)
- Consent of directors and professionals who've given statements must be included in docs
- All docs must be lodged with ASIC

- Must have an exposure period prior to commencing subscriptions to allow consideration from investors and ASIC

Prospectus-

- Required when raising more than \$10mill
- Must contain all info that an investor would require
- E.g. rights and responsibilities attached to securities, assets, liabilities, financial position, profits, loss
- Must disclose professionals with interests in the company as well as their fee/other benefits
- Mandatory inclusions listed in s715
- E.g. identify the company and the nature of the securities on offer, purpose of funds raised, nature of risks involved in investing in securities

Short form prospectus

- Can refer to material lodged with ASIC
- Investors can request the full prospectus

Profile statement

- Only used when given permission from ASIC
- Shorter than a short prospectus
- Prospectus still lodged with ASIC and available at investors request

Offer information statement

- Used when more than \$2mill but less than \$10 mill
- Less disclosed than in a prospectus

Other protections:

- A company must issue a supplementary or replacement prospectus when the original goes out of date

- ASIC may require a them to be issued if it finds issues with the original
- If still incorrect, they will issue a final stop order → can't fundraise with the document
- Cannot accept money if the full subscription is not filled
- Application moneys must be held in a trust until subscription filled and shares allocated
- **S707** anti avoidance measure- stops people issuing to those who don't need a prospectus and then having the person sell to those who would need one e.g. [ASIC v Axis International Management](#)
- General prohibition on:
 - advertising (**s734**)
 - share-hawking/cold calling

Anyone who suffered loss or damages as a result of a defective prospectus can take civil action against:

- The company
- Directors
- Underwriters
- Person named with their consent

Criminal liability is imposed when misleading/deceptive conduct, material omissions or failure to update occurs.

Statutory defences (for prospectus only)-

- Due diligence (**s731**) for defective prospectus
 - Can avoid liability if they showed to have taken reasonable precautions that led to reasonable grounds to believe statements were true and not misleading
- Lack of consent, lack of knowledge, reasonable reliance

Common law remedies-

- Rescission- set aside contract for allotment and recover money paid with interest
- Damages in tort or fraudulent activity (for defective disclosure document
- E.g. *Esanda Finance Corp Ltd v Peat Marwick Hungerford's* (1998)

	<p>Crowd source funding-</p> <ul style="list-style-type: none"> • Amendment act in 2017 deals with crowd funding- applies to unlisted companies with less than 25 mill in assets and revenue • Allows for more than 50 members • Must have 2 directors
5. Discuss: Concept sports case	<p>Cadence Asset Management Pty Ltd v Concept Sports Limited (2005)</p> <ul style="list-style-type: none"> • Candence asset management (CAM) and other investors bought 100k shares (50c each) in concept sports though a prospectus forecasting a large profit • Shares lost 70% of their value in 2 months • CAM sold 6 moths later for 11.5c • CAM claimed a misleading and deceptive prospectus • CAM sought damages under s728 and won
6. ASIC v Axis International Management Pty Ltd (2011)	<p>ASIC v Axis International Management Pty Ltd (No 5)</p> <ul style="list-style-type: none"> • The company was registered in British Virgin Islands • A related company was shareholders in the company • The company on-sold shares to Australian retail investors • There was no prospectus lodged with ASIC • ASIC got <ul style="list-style-type: none"> - declaration of misconduct by directors - publicity order so investors can peruse compensation orders - Banning order of the directors from managing a company for 6 years - Court emphasised that there must be protection for investors
7. Sino Case Australia	<p>ASIC v Sino Australia Oil and Gas Ltd (2016)</p> <ul style="list-style-type: none"> • Original prospectus was replaced by a replacement prospectus and then a supplementary prospectus (all signed by Mr shao- a director residing in china) • Mr Shao couldn't read English and didn't get a translated prospectus • ASIC proved breach of s728 by misleading investors, failing to disclose it won't meet forecasted profits and failure to disclose loan agreement (continuous disclosure requirement)

	<ul style="list-style-type: none"> • Mr Shao also found not to show care and diligence as a director <ul style="list-style-type: none"> - Banned from directing for 20 years - Pay compensation of 5.5 mill to cover losses the company will suffer
<p>8. Describe debentures and charges as well as law reform under PPSA</p>	<p>Debenture- a legal right that includes an undertaking by a company to repay a debt. Includes mortgages and secured loans</p> <ul style="list-style-type: none"> • Debenture holder is a creditor not a member of a company <p>Types of debentures-</p> <ul style="list-style-type: none"> • Unsecured or secured <ul style="list-style-type: none"> - Can be secured by a security interest (used to be called a charge before PPSA) - Debenture secured by land is a mortgage - Unsecured debentures are known as unsecured notes <p>Duties of the borrowing company</p> <ul style="list-style-type: none"> • Must comply with Ch6D • Must prepare a trust deed • Appoint a trustee- overseas debt servicing. Makes sure company isn't breaking trust deed (if broken can go into receivership) • Maintain a register of debenture holding <p>Impact of PPSA</p> <ul style="list-style-type: none"> • Personal Property Securities Act 2009 (Cth) • Provides one online registry for all securities in Australia • Concept of a fixed charge replaced with security interest in a non-circulating asset <ul style="list-style-type: none"> - The security can't be sold without the permission of the lender • Floating charge replaced with security interest in a circulating asset <ul style="list-style-type: none"> - Can be sold without the permission of the lenders • Failure to lodge notice of security interest within 10 days may result in void security against liquidator or administrator • Under PPSA- a registered interest/perfected will take priority over an unperfected interest

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| | <ul style="list-style-type: none">• S588FL -Invalidates a circulating charge created 6 months before wind up of the company
replaces s267 |
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