

The Separate Legal Entity Doctrine and Limited Liability

<i>Salomon v Salomon & Co Ltd [1897] AC 22</i>	
Facts	<ul style="list-style-type: none">-Salomon incorporated his business so he could work with his sons as partners-Mr Salomon took 99% of the company's shares and had £10,000 in debentures-Salomon's business failed and the company was put into liquidation-The company's liquidator contended that the floating charge should not be honoured, and Salomon should be made responsible for the company's debts
Issue	-Was Salomon responsible for the company's debts?
Held	-Salomon was not liable
Rationale	<u>Unanimous Decision:</u> <ul style="list-style-type: none">-The company was duly incorporated, it is an independent person with its rights and liabilities-Provided formalities of the Act were complied with, a one man company does not constitute an abuse of the legislation-The unsecured creditors of the company had only themselves to blame for their misfortunes
KLP	<ul style="list-style-type: none">-Acknowledged the corporate veil-Legitimised the de facto/one man company

<i>Lee v Lee's Air Farming Pty Ltd [1961] AC 12</i>	
Facts	<ul style="list-style-type: none">-Lee formed a company that spread fertilisers from the air-He held 2999 of 3000 shares, was the sole director, and chief pilot-He was killed in a plane crash-His wife wanted to claim damages under the Workers' Compensation Act, which required him to be a 'worker' as defined by the Act-The company was insured (as required) for worker compensation
Issue	-Could Mrs Lee seek compensation from the company?
Held	-Lee could seek compensation
Rationale	<u>Lord Morris:</u> <ul style="list-style-type: none">-The company was a separate legal person-'It is established that the mere fact that someone is a director of a company is no impediment to his entering into a contract to serve the company'-'In their Lordships' view it is a logical consequence of the decision in Salomon's case that one person may function in dual capacities'
KLP	-Affirmed the corporate veil and separate corporate personality

<i>Macaura v Northern Assurance Co Ltd [1925] AC 619</i>	
Facts	<ul style="list-style-type: none">-Mr Macaura held all the shares in Irish Canadian Sawmills Ltd-Mr Macaura was also an unsecured creditor for £19,000-He got insurance policies - but in his own name, not the company's
Issue	-Was the insurance company liable to pay Mr Macaura?
Held	-The insurance company was not liable to pay
Rationale	<u>Lord Buckmaster:</u> <ul style="list-style-type: none">-The insurance was taken out for Mr Macaura, and not the company-Insurers were not liable on the contract, since the timber that perished in the fire did not belong to Mr Macaura, who held the insurance policy <u>Lord Sumner:</u> <p>His relation was to the company, not to its goods, and after the fire he was directly prejudiced by the paucity of the company's assets, not by the fire'</p>
KLP	-Affirmed the corporate veil and separate corporate personality

Allotment of Shares

<i>Re Wragg Ltd [1897] 1 Ch 796</i>	
Facts	<ul style="list-style-type: none"> -Mr Wragg and Mr Martin sold their omnibus and lively stable business to a newly incorporated company for £46,300 -The company paid by issuing debentures and fully paid shares to Mr Wragg and Mr Martin -The liquidator of Wragg Ltd claimed that the company was (in return for the share issue) worth £18,000 less than the board had decided to pay
Issue	-Was the transaction legitimate?
Held	-The transaction was legitimate
Rationale	<ul style="list-style-type: none"> -An allottee must pay the company the issue price of the shares which is the consideration for the share issue -In most cases, the consideration is cash -However, companies may issue shares for a non-cash consideration (in this case the omnibus and stable business)
KLP	- Companies may issue shares for a non-cash consideration

<i>Re White Star Line Ltd [1938] 1 All ER 607</i>	
Facts	<ul style="list-style-type: none"> -There had been a call on shares and the shareholder sought to satisfy the all by issuing deferred creditor certificates -Those certificates entitled the company to receive payment at a later date
Issue	-Was there sufficient consideration?
Held	-Consideration was illusory and was not valuable consideration
Rationale	-Certificates under which the company got no immediate payment but the prospect of payment in the indefinite future does not amount to payment
KLP	<ul style="list-style-type: none"> -The value of the consideration for an allotment of shares must be more than sufficient consideration required under the law of contract -It must represent money's worth for the allotment

Classes of Shares

<i>Cumbrian Newspapers Group Ltd v Cumberland & Westmorland Herald Newspaper & Printing Co Ltd [1987] Ch 1</i>	
Facts	<ul style="list-style-type: none"> -CNG's chairman had 10.67% of the shares in CWHNP -Under the constitution CNG had negotiated special rights which it had bargained for in return for closing down a competing paper, the Cumberland Herald, and for acting as CWHNP's advertising agent -It had the right to preferences on unissued shares, to not be subject to have a transfer of shares to it refused by the directors, pre-emption rights, and the right to appoint a director if shareholding remained above 10% -The CWHNP directors wanted to cancel CNG's special rights -CNG argued they were class rights that could only be varied with its consent
Issue	-Could the rights be varied without consent?
Held	-No they could not
Rationale	<p><u>Scott J:</u></p> <ul style="list-style-type: none"> -CNG's rights are a shareholder could not be varied without its consent because they were a class of rights which conferred special rights <p><u>Three Main Categories of Special Rights:</u></p> <ol style="list-style-type: none"> 1. Rights annexed to shares 2. Rights for a particular people under the constitution 3. Rights unattached to particular shares but conferring a benefit on a group of members

The Indoor Management Rule at Common Law

<i>Royal British Bank v Turquand (1856) 6 E&B 327</i>	
Facts	<ul style="list-style-type: none"> -Turquand, a mining company, had a clause in its deed of settlement that allowed the company to borrow money once it had been approved and passed by a resolution of members in general meeting -Turquand entered into a loan agreement with the Royal British Bank and two of the company's directors witnessed the affixing of the company's seal to that document -However, the company did not obtain shareholder approval -Turquand defaulted on repayments and the bank sought restitution -At that point, Turquand refused to pay on the basis that the directors had no right to enter into such an agreement
Issue	-Was the agreement binding?
Held	-The agreement was binding
Rationale	<p>-The bank could assume that the requisite shareholder resolution had been passed</p> <p><u>Campbell CJ:</u></p> <ul style="list-style-type: none"> -The plaintiffs have bona fide advanced their money for the use of the Company, giving credit to the representations of the directors that they had authority... to execute the bond; and the money which they advanced, and which they now seek to recover, must be taken to have been applied in the business of the Company and for the benefit of the shareholders -If the plaintiffs must be presumed to have had notice of the contents of the registered deed of settlement, there is nothing there to shew that the directors might not have had authority to execute the bond as they asserted
KLP	-Articulates the operation of the indoor management rule at common law

Further Protecting Third Parties: The Statutory Assumptions

<i>ANZ Banking Group v Frenmast Pty Ltd [2013] NSWCA 459</i>	
Facts	<ul style="list-style-type: none"> -Involved a family company Frenmast, run by three brothers who gave ANZ a guarantee -The bank sought to rely on the assumption under section 129(5) that the document had been duly executed -Before that, the bank had to establish that there had been dealing with the company required under section 128(1) -The guarantee in question had been purportedly signed under either section 127(1) or (2), by Robert Tiricovski (director) and Vlado Tiricovski (secretary) -Robert had forged Vlado's signature -The trial judge initially held that it was not valid, but this was overturned by the Court of Appeal
Issue	-Was the guarantee given to ANZ by the company valid?
Held	-The guarantee was valid
Rationale	<p><u>Meagher JA:</u></p> <ul style="list-style-type: none"> -There had been dealing with the company which consisted of communications between it and Robert, in his capacity as a director of the company -In that capacity, he had either the ostensible or actual authority to enter into those communications -He may have lacked actual or apparent authority to enter into the contract itself but ANZ still had dealings with the company and could therefore rely on the assumptions under 129, in particular section 129(5) -It did not matter that the document forged – it appeared to be duly executed
KLP	<ul style="list-style-type: none"> -In order to rely on the statutory assumptions there must have been 'dealings' between the company and the third party -Dealings includes negotiations, communications or other steps

Duty to Act in Good Faith In The Best Interest Of The Company

<i>Re Smith and Fawcett Ltd [1942] Ch 304</i>	
Facts	<ul style="list-style-type: none"> -Article 10 of the company's constitution said that directors could refuse to register share transfers -Fawcett, one of the two directors and shareholders, had died -Smith refused to register a transfer of shares to Fawcett's executors -Half the shares were bought, and the other half offered to the executors
Issue	-Was this done in good faith/in the best interests of the company?
Held	-This was done in good faith
Rationale	<u>The Test (subjective):</u> -Has the director exercised their discretion in good faith in what they consider to be in the best interests of the company?
KLP	-Directors must exercise their discretion bona fide in what they consider (not what a court may consider) to be in the interests of the company and not for any other collateral purposes -In this case the judges were reluctant to question the business decisions made

<i>Hutton v West Cork Railway (1883) LR 23</i>	
Facts	<ul style="list-style-type: none"> -A railway company sold its undertaking to another company at a price to be determined by an arbitrator -The purchase-money was to be applied in paying the costs of the arbitration and in paying off any revenue debts or charges of the company, and the residue was to be divided among the debenture holders and shareholders -After the completion of the transfer a general meeting was held at which a resolution was passed to apply £1050 of the purchase-money in compensating the paid officials, and £1500 in remuneration to the directors
Issue	-Was this done in the best interests of the company?
Held	-This was not done in the best interests of the company
Rationale	<u>The Amiable Lunatic Test:</u> -If the decision of a director is one that no one would reasonably make, the court may reject it <u>Bowen LJ:</u> -Bona fides cannot be the sole test, otherwise you might have a lunatic conducting the affairs of the company, and paying away its money with both hands in a manner perfectly bona fide yet perfectly irrational
KLP	-Outlined the amiable lunatic test

<i>Mills v Mills (1938) 60 CLR 150</i>	
Facts	-The directors of a company passed a resolution which increased the voting power of one of the directors but which was believed by the directors to be in the best interests of the company
Issue	-Was this in the best interest of the company?
Held	-It was in the best interests
Rationale	<u>Latham CJ on Directors Interests and Best Interests:</u> -Just because a director holds shares or otherwise has an interest in a matter, that does not mean that they are not acting in good faith and in the best interests of the company
KLP	-The best interests of the company refers to its members as a collective -There is a requirement to balance the interest of different groups of shareholders and act fairly

Exoneration By The Company

<i>Kinsela v Russell Kinsela (1986) 4 NSWLR 722</i>	
Facts	<ul style="list-style-type: none"> -The company granted a lease of its business premises on commercially questionable terms to the Kinselas while it was in a precarious financial position -It did this because this placed the assets of the company beyond the reach of the creditors and the two directors could use the premises to conduct business -All of the shareholders of the company had approved the lease -The company was wound up three months later and the liquidator sought a declaration that the lease was voidable
Issue	-Could the shareholders exonerate the directors breach?
Held	-The shareholders could not due to the insolvent trading
Rationale	<ul style="list-style-type: none"> -In a solvent company, the interests of shareholders entitled them as a general body to be regarded as the company when questions of duty arise -Where the interests at risk are those of the creditors, shareholders cannot authorise the breach -The interests of the creditors become prospectively entitled through the mechanism of liquidation to displace the power of shareholders and directors -Here the company was plainly insolvent at the date of the lease so there was no issue in determining whether the degree of financial instability imposed upon the directors an obligation to consider the position of the creditors
KLP	-Ratification is not available where the breaches include a failure to take into account the interests of the creditors

<i>Angas Law Services Pty Ltd v Carabelas [2005] HCA 23 at [32] (2005) 215 ALR 110 at 121-122</i>	
Facts	<ul style="list-style-type: none"> -The respondents were the holders of the two issued shares in the company -They were also the only directors -The company was wound up and the liquidator commenced proceedings seeking to recover the amount lost as a result of the contraventions -The shareholders sought to ratify the directors' breach
Issue	-Could the shareholders excuse the breach?
Held	-In this case, the shareholders could excuse the breach
Rationale	<ul style="list-style-type: none"> -The shareholders of a company cannot release directors from the statutory duties imposed by sections 229(2) or 229(4) -If a breach had occurred it would have involved expropriation of the property; a form of abuse of power that could not have been ratified -However, they failed to prove this had actually occurred
KLP	-Except for breaches of statutory directors' duties, shareholders may by ordinary resolution, excuse the directors from liability/ ratify their actions

Relief By The Court

<i>Hall v Poolman [2009] NSWCA 64</i>	
Facts	-A director arguing that he believed on reasonable grounds that the dispute the company was having with the ATO would soon be resolved in the company's favour, and that there was no obligation to sell assets to meet debts because the company's creditors were not pressing for payment
Issue	-Could the court relieve him of liability?
Held	-The court could grant relief
Rationale	<p><u>The Test Regarding Whether The Defendant Has Acted Honestly:</u></p> <ol style="list-style-type: none"> 1. Whether the person has acted without deceit or conscious impropriety; 2. Without intent to gain improper benefit or advantage for themselves or for another; and 3. Without carelessness or imprudence to such a degree as to demonstrate that no genuine attempt at all has been to carry out the duties and obligations of their office

The Statutory Derivative Action
Applicant Acting in Good Faith

<i>Swansson v Pratt (2002) 42 ACSR 313</i>	
Facts	<ul style="list-style-type: none"> -Ms S was a director and shareholder of Pratt Ltd -She sought leave to bring proceedings against H (former director and ex) -S alleged that H had breached the profits rule -Pratt (Mrs Swansson's brother and a director) and the shareholders objected -He also argued that he had been engaged by S to advise her on her property settlement with H as part of their divorce proceedings -Mrs S argued that the transaction was not taken into account in her property settlement and should have been
Issue	Could Mrs S bring derivative action?
Held	-She could not bring action
Rationale	<p>-S had to show that she honestly believed that a cause of action existed and had a reasonable prospect of success; the court held she had an ulterior motive</p> <p><u>-Applicants can show good faith where:</u></p> <ul style="list-style-type: none"> -They are a current shareholder with more than a token shareholding and the derivative action seeks recovery of property to increase share value; and -Applicant is a current director or officer and has a legitimate interest in the welfare and good management of the company which warrants detrimentally
KLP	<p>-In establishing good faith, there are two interrelated factors:</p> <ol style="list-style-type: none"> 1. Whether applicant honestly believes that good cause of action exists and has a reasonable prospect of success; and 2. Whether the applicant is seeking to bring the derivative action for such a collateral purpose as would amount to an abuse of process

<i>Chahwan v Euphoric Pty Ltd (trading as Clay & Michel) [2008] NSWCA 52</i>	
Facts	<ul style="list-style-type: none"> -The appellant sought leave to commence proceedings in the name of the company, claiming that the company held its interest in certain property on trust for him because he provided the purchase moneys -The registered mortgage of that property to the respondent was allegedly granted by a director in contravention of the Act -In challenging 'good faith', the respondent submitted that the appellant sought to take all the proceeds of the claim for himself personally and neither the company nor its creditors would receive any benefit
Issue	-Was the applicant acting in good faith?
Held	-The applicant was not acting in good faith
Rationale	<p><u>Good Faith Test:</u></p> <ul style="list-style-type: none"> -As a current or former SH or director of the company, the applicant would suffer a real and substantive injury if a derivative action were not permitted, provided the injury was dependent upon or connected with the applicant's status as SH or director -There could be a lack of good faith where the applicant's conduct falls short of abuse of process and seeks to further the applicant's personal interests
KLP	-Summarised the good faith test in Swansson