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WEEK THREE – CHARACTERISTICS OF A COMPANY

- ❖ “A company validly incorporated without fraud is a separate legal entity from its members.” ~ *Salomon v Salomon (1986)* → has all the rights of a natural human being
- ❖ **Corporate veil** – the Company has its own legal existence & therefore rights and duties are completely separate and distinct from the people involved e.g. directors, members/ owners, employees
 - Imaginary veil that keeps the people from the company being sued for their actions
 - If a company is set up for illegal purposes, the corporate veil is lifted
- ❖ *S124* – once a company is legally incorporated, it has all legal capacity & powers as a natural human

WEEK FOUR – COMPANY’S LIABILITY IN CRIME, CONTRACT & CSR

- ❖ **Parke v Daily News** – shareholder blocked payment to the widows of the employees, as it would affect their dividends → court held that officers do not owe a duty to consider employees over shareholders
- ❖ *S128-129* – indoor management rule – external parties are entitled to assume that a company’s internal policies have been complied with – assume documents are genuine

WEEK FIVE – INSIDE THE COMPANY – RULES, MEMBERS AND DIRECTORS

- ❖ Board of directors have the power to manage the company – *s198A*
- ❖ Members can make serious decisions e.g. decision to wind up the company, fire directors, approval of capital restructure → they can’t make management decisions e.g. how to run the company
 - Shareholders can’t interfere with management decisions as it would limit director’s powers
- ❖ **Gambotto v WCP Ltd** – minority shareholder; refused to sell his shares – 2 step test
 - *Is it for a proper purpose? i.e. preventing harm to the company*
 - *Is it fair in the circumstances? i.e. the price paid was a fair price*
 - Has to be for a proper purpose, not just financial advantage for the majority

WEEK SIX – ASIC, FUNDRAISING AND DISCLOSURE

- ❖ ASIC has a role as a corporate, market & financial services regulator
- ❖ *S13 ASIC Act 2001 (Cth)* – power to commence an investigation

WEEK SEVEN – DIRECTORS DUTIES PART 1 – S180 & S588G & GENERAL LAW

- ❖ Care, skill & diligence → only civil action; not about reckless or dishonest behaviour, about careless behaviour, so there is no criminal action
- ❖ Compensation → both ASIC & company can seek compensation from individuals responsible
- ❖ **Duty to exercise care, skill & diligence**
- ❖ ***Daniels v Anderson (“AWA case”) – landmark case for minimum standard of care, skill & diligence required – audit revealed deficiencies in internal controls, with information conveyed to the managing director, but not the board***
 - All directors (execs & non- execs) have a continuing obligation to keep informed – attend all board meetings unless good reason to – maintain familiarity with financial status of company
 - Directors may not shut their eyes to corporate misconduct – have a duty to look

GENERAL LAW “FIDUCIARY” DUTY	STATUTORY DUTY
Care, skill and diligence Best interest of the company at all times Good faith Proper purpose No conflict/no secret profit Duties enforced by the company	Care and diligence s180 Good faith s181(1)(a) Proper purpose s181(1)(b) Improper use of position s182 Improper use of information s183 Duties enforced by ASIC
REMEDIES: Equitable compensation Account of profits Constructive trust Injunction Rescission of contract	REMEDIES: Civil penalties Fines Compensation Disqualification Company compensation Criminal penalties

- AWA (co.) sued Daniels (auditor), and then Daniels sued for contributory negligence – the directors failed to exercise a reasonable degree of care & diligence in their duties
- It wasn't about them relying on advice – directors can rely on advice given by internal auditors without breaching their duty
- If a director feels they do not have sufficient business experience, they should acquire it or refuse the office of director
- Delegating defence → could only rely on delegates if they were sufficiently monitoring the company's affairs so as to be aware if there were irregularities
- ❖ **ASIC v Healey (Centro case)** – directors must have basic skills regarding financial statements
 - Directors misclassified \$1.5 bn of CL as NCL – *failure to exercise care, skill & diligence*
 - The Board's breached duty of care & diligence under s180(1) when signing off on accounts
 - *They can't rely on reasonable reliance defence as they should have a basic understanding of business & finance – can rely on others, but have statutory functions they can't delegate*
 - Heavy responsibility, workload & pressure are not excuses – should seek help from professionals & check assumptions made
 - All directors are expected to understand the financial statements of a company – informed
 - Directors must apply an inquiring mind to the responsibilities placed on them
- ❖ **ASIC v Adler** – related party transactions were carried out without the knowledge of the board, no disclosure – undocumented & unsecured payment of \$10 million to related party
 - Adler breached duties under ss181-184 – *disqualified for 20 years, pecuniary penalties*
 - S208 – *when an entity is giving financial benefit to a related party, member approval must be obtained* → a breach does not mean that the contract is invalid, the person who is involved simply contravenes a civil penalty provision under s1317E
 - *Related party – defined in s228* – controlling entities, directors & spouses/ parents & children; a party that acts on the understanding that they will receive a financial benefit
- ❖ **James Hardie case** – directors have a duty to not issue a false statement
 - Issued misleading statement to the ASX, with a shortfall of \$1bn – *despite evidence from expert financial advisers that funding would be insufficient – adverse consequences*
 - Trial court found that each director, CEO, CFO & general counsel had breached duty of care & diligence – s180(1) – they should have known their assumptions meant it was misleading
- ❖ **Donohughe v Stevenson** – merely proving a director has failed to fulfil their standard of care & diligence does not automatically entitle the company to damages – *the company must prove that the director's breach caused the company to suffer loss or damage*
 - On the balance of probabilities, would the result have been the same, had the director acted according to the required standard – *includes reputation of business*
- ❖ **ASIC v Rich** – merely holding the title of a non-executive director will not result in a lower standard of duty; directors are expected to use their knowledge & skills to a reasonable standard
 - General consensus is that all officers are equal in their duties, but level of skill & care expected may change depending on position held – different consequences
- ❖ Apply the **objective test** under s180(1) – what would a reasonable director have done in that situation? – *considering size of the company & industry – what was reasonable?*
- ❖ **Defence #1** – Business Judgement rule – s180(2) – directors must prove (all of the following):
 - Business judgement was made in good faith and for a proper purpose
 - There was no material personal interest – *what was motivating factor behind transaction?*
 - They informed themselves – *did they seek advice to be fully informed?*
 - They had rational belief that the decision was in the company's best interest – *unless no other director in that position would have made the same decision* – they believed that who they delegated to was fully competent
- ❖ Shareholders hope investments will result in future profitability – *expect directors to obey their duties*

- ❖ As a general rule, courts will not interfere with business judgement, that was rational and made in good faith (through hindsight)