WEEK 1 – Company Law

Company Law is the general term used to describe laws which govern:
- Formation and termination of companies
- Characteristics of companies
- Relationships between those participating in companies (directors, officers, shareholders, creditors)
    - There are rules and responsibilities for each
- Companies dealing with outsiders

Company law aims to:
- Provide investor protection
- Provide commercial stability and consumer confidence
- Balance competing interests
- Provide certainty through the standard form rules

Company law rules come from:
1. Corporations Act 2001 (legislation/statute)
2. Case law (precedents)

Private vs Public Company Law
- Private = disputes between the company and its shareholders
    - Goes to civil court as this is issues between individuals
- Public = allows ASIC to punish wrongdoers and seek compensation
    - ASIC goes after the breach and chooses which cases to prosecute
    - They choose not to intervene in many cases

Separate Legal Entity Doctrine
- The company is a separate legal person from its owners ('artificial legal person')
- Companies can legally do most things a human can do eg. Purchase property
- As well as additional activities eg. Issue shares (s 124)

Benefit: separates the companies' problems from its shareholders and directors eg. Debt
Cost: companies money belongs to the company (and therefore must be distributed formally in some way for shareholders to receive it)

Salomon v Salomon (1987) [3 – 120, 3 – 420]
- First case which recognised the company as a separate legal entity
- Mr Salomon incorporated his shoe business and issued himself shares; the company gave him some cash but not all so issued a debt with the shoe business as security
- It went into liquidation and Mr Salomon seized back the business
- **Issue:** was Mr Salomon entitled to priority pay back under the debenture over other unsecured creditors of the company?
- **Court said yes:** company is a separate legal entity and therefore Mr Salomon is entitled to act as different roles within the company

Lee v Lee's Air Farming Ltd [3 – 140]
- Mr Lee was the founder, majority shareholder and employee at the company
- He had a worker's compensation insurance policy on his life and was killed air farming, his widow claimed the policy
- Insurance company said Mr Lee couldn't be an employee as he was everything in that company
- **Issue:** could Mr Lee be both controller and employee of a company?
- **Court said yes:** the company is a separate legal entity so he could be both

Macaura vs Northern Assurance [3 – 140]

- Mr Macaura owned a plantation and insured it in his name
- He then incorporated a company and transferred the plantation to it, but the company did not take out an insurance policy
- The land burnt down, Mr Macaura claimed on his insurance policy, but the insurer argued it was in his name and he didn't own the land, the company owned the plantation but did not have an insurance policy
- **Court said no:** Mr Macaura could not claim the insurance as he did not own it

Management Structure

1. **Small Companies:** owners/shareholders might also be directors and employees
2. **Larger Companies:** run by board of directors who manage the business or supervise management (CEO and other senior executives)

- Board is made up of a chair, managing director (and/or CEO) and 8-10 other non-executive directors (people from outside the company)
- Directors don't have to be shareholders

*in between small and large companies there are many arrangements of companies

- Generally small: main shareholder runs it, large: board steps in

Shareholders have a right to vote on some issues

- Control votes: appointing board of directors and company constitution
- Veto/approval votes: board puts idea to shareholders, they vote yes/no

*but they don't usually vote on, or get to decide, general management decisions

Capital Structure

1. **Equity Capital**

- Contributed to the company by shareholders/owners/members in exchange for shares (percentage of the company)
- Generally, not repaid during the life of the company
    - Shareholders are bottom of priority list for pay back in liquidation
    - Cannot get money out during life of the company except for very specific rules being followed
- Risky as don't hold much control, however, are an owner of the company and hope for dividends and growth on their shares

2. **Debt Capital**

- Owed by the company to outsiders called 'creditors' eg. Suppliers, lenders etc.
    - All money owed by the company is called a debt
- Can be secured debt (lender has some form of security) eg. Mortgage
- Must be paid whether the company is profitable or not
    - Dividends only paid where the company is profitable and chooses to
- Do not include any control or voting rights
- Company becomes insolvent and is liquidated if it cannot pay its debts

*companies must find a balance between equity and debt as each have advantages/disadvantages

Priority List (for pay back/recovery)

1. Secured Creditors
2. Priority creditors (firstly, companies liquidator, secondly, the employees)
3. Unsecured creditors
4. Shareholders

What are Shares?

- Claims against the company to which 'rights' attach
- Many different rights, which depend on the particular type of shares
    - Right to dividend is not absolute as company decides when and if they pay
- Valuable assets which can be sold by the shareholder

    - But shareholders do not own company assets (separate legal entity)
- Companies can be shareholders in other companies

Classes of Shares

- Shares can have different rights attached to them
    - Eg. Dividends 'rights', voting rights
- Includes rights and priorities to the repayment of capital or surplus (profit) paid by the company on winding up (solvent liquidation)
    - First to get their share capital during solvent liquidation and potentially a right to surplus if everyone has received their share capital
    - Called 'class rights'
- Company decides these classes and rights: s 254B

Preference Shares

- Usually carry rights to:
    - A fixed dividend (eg. 5% dividend)
    - Priority for repayment of capital (as above)
    - But limited voting rights
    - No right to share surplus on winding up
- Shareholders approve these rights: s 254(2)
- May also be other shareholder approvals required eg. Variation of class rights

Limited Liability

- The company's debts must be paid by the company, not the shareholders
    - S 516 Company's limited by shares: a member's liability to pay the debts of the company is limited to the amount (if any) unpaid on their shares
    - If shares are fully paid for, no further contribution required (no liability)
- However, company may issue partly paid shares (s 254M)
    - Shareholder must contribute further is a 'call' is made
    - If call is not paid (this is a debt owed and liquidator can chase up) and the shares may be forfeited

*Directors have the power to issue shares (s 198A) but the issue of shares may require shareholder approval in some circumstances

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