General Information about companies

S 124 (p.693) → legal capacity and powers of a company, including issuing/cancelling shares (s 124(1)(a))

Separate Legal Entity

- Companies are **separate legal entities,** meaning the company, in its own name, can own property, enter contracts and sue and be sued (s 119)
    - **Salomon**
    - **Salomon**
    - **Lee v Lee's Air Farming Ltd**
- A company's **property is not the property of its participants**
    - **Macaura**

Limited Liability & The Order of Liquidation

- **A company limited by shares** is a company formed on the principle of having the liability of its members limited to the amount (if any) unpaid on their shares – s 9
- In a company 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** – s 516
    - **Edwards v Attorney-General of NSW**
- The order of liquidation: **EVERY LEVEL MUST BE PAID IN FULL BEFORE THE NEXT LEVEL CAN BE PAID**

Secured creditors (banks) → priority creditors (liquidator and employees) → unsecured creditors (customers, suppliers, contractors) → shareholders (usually receive nothing)

Shares and Capital Maintenance

- A tradeable asset which holds claims against a company to which rights attach
    - Control rights → voting
    - Distribution rights → dividends

Partly paid shares

- Pt. 2H.3 → shares where only a part of the subscription price is paid, with the balance to be paid later
- A shareholder is liable to pay **calls** on the shares in accordance with the terms on which the shares are on issue. This means that a company can sue the shareholder to recover the amount owing on the call - s 245M(1) (p.792)
- Rights and the calls and forfeiture procedure ought to be set out in the constitution, as they are not provided for under replaceable rules
- Why offer partly paid shares?
    - Limits the expectation of returns from shareholders
    - Companies can avoid the costs of continually issuing shares by issuing one large quantity of partly paid shares (esp. if the company doesn't require funding atm)

Preference shares

- A company can only issue preference shares only if the rights attached to them with respect to prescribed matters are set out in **company's constitution** (if any) **or** have been approved by **special resolution** – s 254A(2) (p.788)
        - This requires a general meeting of the company's shareholders at which 75% of the present shareholders holding voting shares vote in favour of adopting the particular term: s 9

- Notice of issue must be lodged with ASIC
- **Any rights whatsoever can be attached to preference shares** (they do not have to follow the typical pattern of fixed dividends, priority for repayment of capital, limited voting rights and no right to share in surplus on liquidation)

Votes

- **One vote per (ordinary) share** – RR s 250E(1)(b) (p.779)
- One vote per ordinary share → ASX listing rule (p.406)
- The **chair** has a **casting vote**, and if they are a member, any vote they have in their capacity as a member – RR s 250E(3) (p.779)

Who must be notified?

- Within 28 days after issuing new shares, the company must notify ASIC of the details of the issue in accordance with s 254X

Issuing Shares

Power to issue shares

- A company has the power to issue/cancel shares – s 124(1)(a) (p.693)
- A company has the power to issue **bonus**, **partly-paid**, **preference** and **redeemable preference** shares – s 254A(1) (p.788)
- A company may determine the terms of issue, and the rights and restrictions attaching to the shares – s 254B(1) (p.789)
- **Board of directors** has the power to issue shares, decide the number of new shares to be issued, the terms and subscription prise under RR s 198A(2)
    - The first step in issuing shares, therefore, is for the board of directors to vote on the issue of issuing shares and passing the resolution
- The issuing of shares is still subject to **DIRECTORS' DUTIES**, particularly proper purpose: s 181
    - "Improper purpose" includes fighting off a hostile takeover in circumstances that would benefit shareholders, intentionally diluting someone's shareholding, or entrench a director's position on the board
- The issuing of shares can count as a financial benefit under a **Related Party Transaction** – s 229(3)(e)

When is member approval required?

- **If creating a new class of shares requires amending the constitution to set out the rights attaching to the new shares**
    - s 254A(2) - **If the new issue is issue of preference shares** where the rights attaching to the new preference shares are not set out in the constitution, **a special resolution of members** will be required either to **amend the constitution to set out those rights**, OR to **approve those rights** (which is simply recorded in the *minutes*. <u>Rights approved does not mean issuing is approved, e.g. VCR procedures</u>)
- **If there is a variation of class rights:** s 246B and s 246C
- **If the related party transactions provisions apply –** public company members approving
- **If constitution, replaceable rules or a members' agreement require**

PROPRIETARY COMPANY Issuing New Shares

- There are a few restrictions on issuing shares
- **S 113(1)** – **Maximum of 50 non-employee shareholders**
- **S 113(3)** – A proprietary company **MUST NOT** engage in any activity that would require disclosure to investors under Chapter 6D (i.e. inviting the public to subscribe for shares), **except** for an offer to its shares to:
  - (a) Existing shareholders; OR
  - (b) Employees of the company or of a subsidiary of the company
  - S 113(3A) - S 113(3) is a **strict liability offence**
- S 113(4) – An act or transaction is not invalid merely because of a contravention of s 113(3)
- **RR s 254D(1)** – **Pre-emption clause for Pty Ltd** (p.790) – Before issuing shares of **a particular class**, the directors of a proprietary company must offer them to the existing shareholders of **that class (i.e. the new shares must be the SAME as the existing class for this pre-emption clause to work)** in proportion to the number of shares of that class they already hold

PUBLIC COMPANY Issuing New Shares

- Public companies proposing to offer new shares for subscription must comply with the extensive disclosure obligations under Chapter 6D, except in certain limited circumstances
- **Public companies must provide public disclosure statements (PDS, e.g. prospectus) to investors in connection with a share offer which must be prepared and lodged with ASIC, unless requirement exempted under s 708** **(Pty Ltd can also issue shares under these exemptions)**
  - **S 708(1)** – **Small-scale, personal offers** – personal offers to maximum of 20 new investors with a maximum of $2mill (in total) within 12 months
    - S 708(2) – a **personal offer** is one that may only be accepted by the person to whom it is made, and the person is not a 'stranger' (p.862)
  - **S 708(8)** – **Offers to Sophisticated Investors** - $500,000 or more, and a sophisticated investor is a person who has net assets of $2.5mill or a gross annual income of at least $250,000
  - **S 708(11)** – **Offers to Professional Investors** – Rich investors who have/control more than $10mill in assets

The Payment of Dividends

- **S 254T** – **Dividend Test: Circumstances in which a dividend may be paid**
  - (1) A company **MUST NOT pay** a dividend unless:
    - (a) **Assets exceed its liability immediately before** the dividend is declared and the **excess is sufficient** for the dividend payment (balance sheet solvency); AND
    - (b) The dividend payment **is fair and reasonable to the shareholders as a whole** (e.g. you cannot only give one class of shareholders dividends and not the other); AND
    - (c) The dividend payment **does not materially prejudice the company's ability to pay creditors** (e.g. if the company would become insolvent due to payment)
  - S 254T does NOT authorise the **return of share capital** by dressing it up as a dividend, because it tells you when you CANNOT pay dividend, not when you can.
  - **Criminal consequences:** sch 3 penalty
- **RR s 254U** – **Who determines payment of dividends**
  - (1) The **directors** may determine that a dividend is payable and set (subject to s 254T):

        - (a) The amount;
        - (b) The time for payment
        - (c) The method of payment (including payment of cash, issue of shares)
    - (2) Interest is not payable on a dividend
- **S 254W** – **Dividend rights of shares** (note **Ltd** and **Pty Ltd** difference)
    - **(1)** Each share in a class of shares in a **public company** has the same dividend rights unless:
        - **(a)** The constitution provides for the shares to have different dividend rights; OR
        - **(b)** Different dividend rights are provided for by special resolution of the company
    - **RR (2)** Subject to the terms on which shares in a **proprietary company** are on issue, the directors may pay dividends as they see fit

Capital Maintenance

- The requirement that companies maintain their share capital is now represented by Chapter 2J
    - **Financial Assistance**
    - **Self-acquisition**
    - **Permitted share buy-backs → CHOICE**
    - **Reductions of capital → NO CHOICE**

PROHIBITED FINANCIAL ASSISTANCE FOR THE ACQUISITION OF SHARES

- **"Financial assistance"** - Ascertained by examining the **commercial realities** of the transaction: **Charterhouse Investment**
    - Payment,
    - A loan
    - A security for a loan
    - Issue or transfer of shares
    - Paying a dividend
    - A guarantee
    - A gift.
- **S 260A(1)** – A company **may financially assist a person** to acquire shares in the company or a holding company (s 46 – parent and subsidiary relationship) of the company **ONLY IF**:
    - (a) Giving the assistance **does not materially prejudice** (i) the **company's OR the shareholders' interests**; OR (ii) the company's ability to pay its **creditors**; OR
        - **"Material prejudice"** is a question of fact regarding a commercial transaction as a whole
            - If company withdraws a large amount of money from its bank and lends it to a company that is near insolvency
            - If a company guarantees a loan to another company that is likely to default
            - **ASIC v Adler** – company was impoverished overall by transaction, conversion of a company asset into one of lesser quality (e.g. where cash is converted to an unsecured loan without interest to the purchaser of shares). Shares were purchased in holding company (s 46 definition). No shareholder approval and the assistance wasn't exempt
    - (b) The assistance is **approved by shareholders** under **s 260B** (which also requires advance notice to ASIC); OR
    - (c) The assistance is **exempt** under s 260C (don't have to know exemptions)

- **S 260E** – Even if a financial benefit is not prohibited by s 260A, or is approved by shareholders under s 260B, or is exempt under s 260C, company's **directors' are NOT relieved of their duties in deciding whether to provide it**
- **Consequences for Breach**
    - **S 260D**
        - **(1)** The transaction is STILL valid and the company is NOT guilty of an offence
        - **(2)** Any **person involved** in the company's contravention of s 260A contravenes this subsection, and is liable for a **civil penalty breach** (s 1317E)
            - **"Involved"** is defined under s 79: a person who is involved is a person who aided or induced; or in anyway by act or omission; or conspired with others to effect the contravention
            - Following a declaration of contravention, a court may impose:
                - Pecuniary penalty up to $200,000: s 1317G
                - Disqualification order from managing companies for a specified period of time: s 206C
                - Compensation to the company for any loss or damage incurred because of the breach: s 1317H
            - **Companies can also apply to the court directly for compensation under s 1317J(2) and s 1317H even if there is no action by ASIC**
    - **S 260D(3) –** Commits a criminal offence if the involvement is dishonest

PROHIBITED SELF-ACQUISITION

- **S 259A** – A company MUST NOT acquire shares in itself (including issuing/transferring shares to a controlled entity (s 50AA) or acquiring shares in a controlling entity) EXCEPT
    - (a) In buying back shares under s 257A
- Therefore, **failure to do a share buy-back properly** under **s 257A** is a **breach** of **s 259A**
    - **S 257A** – A company may buy back its own shares if:
        - (a) The buy-back does not materially prejudice the company's ability to pay its creditors; AND
        - (b) The company follows the procedures laid down in **s 257A to s 257J**
    - **Does not extend to redeemable preference shares**: Part 2H.2
- **Consequences for Breach**
    - **S 259F(1) –** If a company contravenes s 259A:
        - **(a)** Transaction is STILL valid despite contravention; AND
        - **(b)** The company is NOT guilty of an offence
    - **S 259F(2) –** Any person **involved** in a company's contravention of s 259A breaches this section and is liable for a **civil penalty breach** (s 1317E)
        - **"Involved"** is defined under s 79: a person who is involved is a person who aided or induced; or in anyway by act or omission; or conspired with others to effect the contravention
        - Following a declaration of contravention, a court may impose:
            - Pecuniary penalty up to $200,000: s 1317G
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