

MLL331 CORPORATE LAW

- HD COMPREHENSIVE NOTES -

T1 2020

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1 REGULATORY FRAMEWORK

INTRODUCTION + HISTORY

Corporate law = structure and regulation of corporate entities

Why is company law important?

- "The limited liability corporation is the greatest single discovery of modern times. Even steam and electricity are less important than the limited liability company". — N M Butler, President of Columbia University, 1911.
- "We may think this is a rather extravagant claim, but its general thrust is clear, and telling: the importance of the corporate form and of limited liability over the past century and a half has been immeasurable; the greater part of the commercial expansion, the scientific development and the many other achievements which have changed the shape of society during and since the industrial revolution have come about through the medium of the limited company". — LS Sealy, *Company Law and Commercial Reality* (1984).
- companies are essential actors in the economy — they are the entity of choice for business and commerce in Australia and internationally

History of company law

- 15th century — corporate aggregates created by Royal Charter granted to monasteries, boroughs and trade guilds
- Revolution of 1688 — companies created by Private Acts of Parliament

Joint Stock Companies

- 17th century —
 - joint stock companies
 - unincorporated entities
 - basis of the modern day company
 - shares transferrable
 - voting rights attached to shares
 - profits distributed through dividends
- *Bubble Act 1720* (UK) —
 - speculation in joint stock shares
 - South Sea Company
 - Bubble Act — confines trading to the sale of shares in formally incorporated bodies
- 1825 — Bubble Act repealed
- 1844: Incorporation by registration —
 - i.e. not by Royal Charter or Act of Parliament
 - distinct legal entity with perpetual succession **but** shareholders did not have limited liability
 - "... legislative ancestors of modern company law." (Ford, p. 41)
- *Limited Liability Act 1855* —
 - liability of investors 'limited' to the amount they agreed to invest
 - catalyst: large amount of capital required to finance new railways
 - 'limited' at end of company's name warned of shareholder's diminished liability (Today: Ltd, Pty Ltd)

Company law in colonial Australia

- *Companies Act 1862* (UK) — adopted by Australian colonies as their company law
- Late 19th century Victorian Developments —
 - need for capital to fund gold mining prompt unique Victorian company law developments
 - 1871: no liability mining company
 - 1896: failures in the 'land boom' lead to restrictions on 'proprietary companies' — compulsory audit and annual presentation of financial statements
- 1901: Federation —
 - **s 51(xx)** Constitution: The Parliament shall... have power to make laws ... with respect to: ... Foreign corporations, and trading or financial corporations **formed** within the limits of the Cth
 - each state retained its own company legislation

Quest for Cth/State uniformity

- 1961: 62 cooperative regime — states enacted uniform companies legislation, but the state Acts were not uniform and variations increased with time
- *Companies Act 1981* (Cth) —
 - Cth enacted *Companies Act 1981* (Cth) in ACT and NT per **s 122** Consti
 - each state enacted a Companies Code that was uniform with the Cth Companies Act

Quest for Cth Control

- *Corporations Act 1989* (Cth) — Cth legislated independently of the States to introduce a national scheme: *Corporations Law* scheme
- *NSW v Cth* (1990) — HC held that the Cth lacked power under the Constitution to make laws about the incorporation of companies

The road to company law harmony in Australia

- Today, companies are regulated by Commonwealth legislation, the *Corporations Act 2001* (Cth)
- Originally, company law was regulated by each State (and the Commonwealth on behalf of the Territories)
- This fragmented 'federal' system resulted in 7 separate sets of legislation that regulated company law in Australia
- Throughout the 20C, attempts were made to cooperate between the States and Commonwealth to achieve a uniform companies law
- These attempts were not very successful, so in 1989 the Commonwealth tried to take control and legislate for all States (so there would be just one piece of legislation)
- Problem: **s 51(xx)** of the Australian Constitution
- HC in *NSW v Cth* (1990) said the Commonwealth did not have the power under **s 51(xx)** of the Constitution to legislate in relation to the 'incorporation' of companies
- After this, the States all agreed to refer their powers in respect of companies to the Commonwealth
- Commonwealth then passed the *Corporations Act 2001* (Cth)

Section 51(xx) of the Australian Constitution

- **s 51(xx)** empowers the Commonwealth Parliament (i.e. **not** the States) to: "make laws ... with respect to ... foreign corporations, and trading or financial corporations **formed** within the limits of the Commonwealth"

NSW v Cth (1990)

- does **s 51(xx)** grant the Cth the power to make laws in relation to the 'incorporation' of companies?
- s 51(xx) empowers the Cth to: "make laws ... with respect to... foreign corporations, and trading or financial corporations **formed** within the limits of the Commonwealth"

Held — majority of High Court (6:1)

- the word 'formed' is used in the past tense to refer to companies that have already been incorporated
- this means the Cth **cannot** rely on **s 51(xx)** to make laws about bringing new companies into existence (i.e. the process of incorporating companies)
- "the power conferred by **s 51(xx)** to make laws with respect to artificial legal persons is not a power to bring into existence the artificial legal persons upon which laws made under the power can operate" (para 8)

Corporations Act 2001 (Cth)

- state referral of power to the Cth under **s 51(xxxvii)** Consti
- Act commenced operation on 15 July 2001
- The Cth was able to enact this legislation after the States agreed to refer their power over corporations to it
- The Corps Act is to be read in conjunction with the principles of common law relating to companies which have evolved over the years

Note: referral needs **continuous renewal** (see right)

REGULATORS

There are 3 main regulators:

- 1) Australian Securities and Investments Commission (ASIC)
- 2) Australian Stock Exchange (ASX)
- 3) Takeovers Panel

1) The Australian Securities & Investments Commission (ASIC)

- Commonwealth Agency (b/c referral of State power); ASIC is the principal body charged with the administration of the law relating to companies
- responsible for ensuring the *Corps Act* is complied with
- legislative authority:
 - *ASIC Act 2001* (Cth)
 - *Corporations Act 2001* (Cth)
- powers include:
 - investigate breaches of the *Corps Act* — includes power to compel a person to produce all relevant books and records
 - instigate civil proceedings and criminal prosecutions (concurrent with DPP)
 - advises ministers on necessary changes to the *Corps Act*
 - educational role
- more than 2 million Australia companies; 99% of these companies limited by shares
- Accountability of ASIC: The Parliamentary Joint Committee on Corporations and Financial Services is elected to provide some level of parliamentary supervision over the operations of ADIC

2) Australian Stock Exchange

- private company
- public companies that 'list' on the stock exchange 'contract' with the ASX that they will comply with the Listing Rules

3) Takeovers Panel

- a peer reviewed body at least 5 members; The Takeovers Panel has been established as the primary forum for the resolution of disputes arising from takeover transactions
- important part of the machinery for the control of company takeovers (Formerly, these powers were held by the Courts)
- has power to declare 'unacceptable circumstances'

OTHER REGULATORS

- The **Companies Auditors and Liquidators Disciplinary Board** — established to register and discipline company auditors and liquidators who do fail to discharge their duties properly

RECENT REFORMS

- The *Insolvency Law Reform Act 2016* (Cth) aims to promote a high level of practitioner professionalism and competency, enhance transparency and communication between insolvency practitioners and stakeholders, and promote increased efficiency in insolvency administration.

2 REGISTRATION & ITS EFFECTS

WHAT IS A COMPANY?

There are 3 main concepts re: company

- 1) **Separate legal entity**
- 2) **Limited liability**
- 3) **Perpetual succession**

1) SEPARATE LEGAL ENTITY

- on registration, a company becomes a separate legal person: **s 119**
- **s 124**: The company has the legal capacity of —
 - natural person (own property, contract (*Salomon v Salomon & Co Ltd*), sue and be sued)
 - body corporate (issue shares, grant a security interest)
- a company is a separate legal entity even though a single person manages and controls it: *Salomon v Salomon & Co Ltd* (see more below)

Consequences of treating the company as a separate legal entity

- Company's obligations and liabilities are its own, and not those of its participants
 - Shareholders have limited liability
 - Liability of shareholders is limited to the amount they have not paid on their shares.
 - So if a shareholder has fully paid for the shares – he has no liability
 - If only paid \$1 on a share that was issued by a company at the price of \$3 – the shareholder's liability would be limited to the amount unpaid on the share - \$2
- Company can sue and be sued in its own name
- Company has perpetual succession
- Company's property is not the property of its participants
- Company can contract with its participants
- A person may **concurrently** have a variety of legal relationships with a company (e.g. director, shareholder and employee): *Lee v Lee's Air Farming Ltd* [1961] AC 12

Example:

A and B each own 50% of the shares in AB Co Pty Ltd. There are no shareholders. AB Co owns property worth \$1 million. What's A's interest in the property? Answer: no interest, property owned by company, not shareholders (separate legal entity)

Example:

You go into a Telstra shop to get a mobile contract. The sales rep promises great coverage. He takes your details and issues the contract. The service is (surprisingly) terrible. Whom do you sue? Answer: Telstra (company)

2) LIMITED LIABILITY

- Liability of shareholders is **limited to the amount unpaid on their shares**

3) PERPETUAL SUCCESSION

- the corporation continues to exist despite the death, bankruptcy, insanity, change in membership or an exit of any owner or member, or any transfer of shares.

Case examples

Salomon v Salomon & Co Ltd [1897] AC 22

- Mr S was the sole trader of a shoe and leather business. Co Act 1862 (UK) required 7 shareholders. Salomon & Co Ltd incorporated.
- Mr S 99% shareholder and managing director. Mr S sold business to Co for shares and secured debt. Business failed, assets of Co insufficient to repay secured (Mr S) and unsecured creditors.
- liquidator argued that because the business operated by the Company was the same as that operated by Mr S, and because Mr S had effective control of the company, the court should hold Mr S liable for the loss suffered by the company

Held — House of Lords:

- a company is a separate legal entity even though a single person manages and controls it
- a company can contract with its controlling participants
- "The company is at law a different person altogether from the subscribers to that memorandum [shareholders]; and, though it may be that after incorporation the business is precisely the same as it was before, and the same persons are managers, and the same hands receive the profits, the company is not in law the agent of the subscribers or trustee for them. Nor are the subscribers as members liable, in any shape or form, except to the extent and in the manner provided in the Act" (Lord Macnaughten at 51)
- In rejecting the agency argument, Lord Halsbury LC observed: "I observe that the learned judge (Vaughan Williams J) held that the business was Mr Salomon's business, and no one else's, and that he chose to employ as agent a limited company; and he proceeded to argue that he was employing that limited company as agent, and that he was bound to indemnify that agent (the company). I confess it seems to me that that very learned judge becomes involved by this argument in a very singular contradiction. Either the limited company was a legal entity or it was not. If it was, the business belonged to it and not to Mr Salomon. If it was not, there was no person and no thing to be an agent at all; and it is impossible to say at the same time that there is a company and there is not." (31)

Lee v Lee's Air Farming Ltd [1961] AC 12

- Company operated a crop dusting business. Mr Lee was the main shareholder and managing director of the company. Mr Lee was also employee pilot. While working, Mr Lee was killed in a plane crash. Mrs Lee claimed she was entitled to workers compensation because Mr Lee was an employee. Insurer argued Mr Lee could not be an employee and employer.

Held — Privy Council:

- a company is a separate entity from its controller — who may also be its sole employee
- a company is a separate legal entity and a person may concurrently have a variety of legal relationships with that company

Macaura v Northern Assurance Co Ltd [1925] AC 619

- Macaura (M) assigned right to timber to a company, received shares in consideration. Timber destroyed in fire. M claimed insurance — policy was in his individual name, not in name of company.

Held — House of Lords:

- shareholders do not have a proprietary interest in a company's property
- insurance legislation required policy holder to have an 'insurable interest' in the property
- the company was the owner of the timber, not M (meaning he did not have an 'insurable interest' and so could not claim on the insurance for the damaged timber)

- Lord Buckmaster: "no shareholder has any right to an item of property owned by the company, for he has no legal or equitable interest therein. He is entitled to a share in the profits while the company continues to carry on business and a share in the distribution of the surplus assets when the company is wound up."

What is a 'corporation' for the purposes of **s 51(xx)** of the Constitution?

CEPU v Queensland Rail (2015) 256 CLR 171

- QRTA Act 2013 (Qld) established the Queensland Rail Transit Authority
- all the powers of an individual — specifically including power to enter into contracts, acquire, hold, dispose of, and deal with property, employ staff, appoint agents and engage consultants
- may sue and be sued in the name it is given
- **'is not a body corporate'**. Why? — if QR is not a 'constitutional corporation' it would not be subject to commonwealth industrial relations laws (*Fair Work Act*)

Held — French CJ, Hayne, Kiefel, Bell, Keane & Nettle JJ

- 'the [QRT] Authority is created as a separate right and duty bearing entity. It may own, possess and deal with real or personal property. It is an entity which is to endure regardless of change in those natural persons who control its activities and, in that sense, has 'perpetual succession'. Its constituting Act provides for mechanisms by which its assumption of rights and duties may be formally recorded and signified. The Authority has "the full character of a corporation." [38]

Held — Gageler J:

- 'the statutory declaration that Queensland Rail is not a body corporate ... is ineffective to prevent Queensland Rail answering the constitutional description of a corporation. It answers that description because it is an entity established by law with capacity to own property, to contract and to sue' [49].
- 'Queensland Rail has legal personality because it is legislatively conferred with capacity to own property, to contract and to sue. It is unnecessary to consider whether any lesser subset of those attributes might suffice. The statutory declaration that Queensland Rail is not a body corporate does not deprive Queensland Rail of any of those attributes' [67].

PIERCING THE CORPORATE VEIL

- legal rules that grant the company 'separate legal personality' and separate the company from its participants (e.g. shareholders, directors) are referred to as the veil of incorporation or corporate veil
- *Salomon's* case established that a company and its participants **must be treated separately** — i.e. the corporate veil protects the company's participants from liability
- this is the general rule in Australia

Only in **exceptional circumstances** will a court pierce the corporate veil and disregard the separate legal personality of a company:

Common law exceptions —

- 1) Where company used to avoid existing legal duty
- 2) Where company used to perpetrate a fraud

Statutory exceptions —

- 1) Insolvent trading
- 2) Debts incurred as trustee