

# **CORPORATE LAW NOTES**

**Nicholas Saady 2015**

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# **CORPORATE GOVERNANCE**

## **CONSTITUTIONS AND REPLACEABLE RULES**

- Historically required:
  - Memorandum of association
  - Articles of association
  - NOTE: often used a template – the “Table A” pro forma
    - Saved drafting a specific one
    - Described individual’s power in corporation, meeting requirements etc.
- Now NO requirement to have a constitution (**s 135**)
- If not, will be governed by replaceable rules (**s 135**)
  - Statutory rules presumed to apply to a company without a specific constitutional rule replacing them
  - Listed in **s 141** table – refer to shares, meetings, employees etc.
  - Can be displaced:
    - Company may opt out of these rules by creating a Constitution which rebuts or replaces specific rules
    - Replaceable for both types of company (private/public)
      - BUT some will be mandatory for public
  - DO NOT apply to single person companies (**s 135(1)**)

### **Options with respect to Replaceable Rules**

1. Rely solely on RRs, without a constitution
  - A) Simpler – RRs easily accessible in CA
2. Adopt own constitution displacing RRs wholly or partly (**s 136**)
  - A) Except for mandatory rules if public company
  - B) Usually done because RRs are seen as too basic in their scope
3. Single person company
  - A) RRs inapplicable as unnecessary – no relationships in the company to govern
  - B) BUT still have special rules applicable from ss 198E, 201F & 202C

**NOTE**: Failure to comply with RRs is not itself a contravention of the Act (**s 135(3)**)

# INSOLVENCY

- When a company cannot meet their debts as and when they fall due (s 95A(2))
  - Company will be solvent only when it is able to pay all its debts (s 95A(1))
  - ONLY needs to be one debt
  - Look at cash flow rather than balance sheets
- Forms of external (non-director) administration (Reg 7.5.02(1))
  - Voluntary administration
  - Receivership
  - Winding up the company (liquidation)
  - Schemes of arrangement (“eclipsed by” Voluntary Admin mechanism)
- If Directors allow company to trade and incur debts while insolvent, they may be personally liable for losses sustained by creditors [fid duties] (ss 588G, 588FA)
- Order of priority of repayment
  - Secured creditors = lend money with security over company assets, having right to take possession of this asset if loan is not repaid
    - Usually have rights they may enforce before unsecured creditors
    - EG: bank taking a mortgage
  - Unsecured creditors = lend money without taking security over any company asset
  - Shareholders

## INDICIA OF INSOLVENCY

***Lewis v Doran* [2004] NSWSC 608** [75] (Palmer J) and ***ASIC v Plymin* [2003] VSC 123** at [386]

- Continuing losses
- Liquidity ratios below 1
- Overdue taxes
- Inability to borrow further funds or to raise further capital
- Bank requests to reduce overdraft
- Changing supply terms to COD, or otherwise demanding special payments before resuming supply
- Failure to pay within trading terms
- Post dated or rounded sum cheques
- Dishonoured cheques
- Special arrangements with selected creditors
- Enforcement action taken by creditors
- Inability to produce timely and accurate accounts

## Winners and Losers:

Type	Winner	Loser
Liquidation	Unsec cred	Dir and emp
Receivership	Sec cred (appt)	Other cred, emp
SOA	Large cred, emp	Small cred
VA	Unsec, emp, dir	Owners/lessors

## THE CORPORATE VEIL

- Company has a separate legal personality regardless of the number of people involved or its size (**Lee; Salomon**)
- Lifting the veil = making person behind the corporation legally liable
- NO GENERAL STATUTORY PROVISIONS which impose personal liability
  - BUT some statutory provisions impose liability on parties such as directors/SH

### STEPS:

**What is the purpose of piercing/lifting the corporate veil?**

**Is there an applicable statute which will receive the desired outcome? If so, apply words of the Act.**

**Consider accessorial liability (eg CA or ACL)**

If you're applying statute – don't worry about veil piercing. Just apply the statute, look for a provision that allows the imposition of liability - ie "if the corporation is involved in a contravention (EG. selling dangerous goods) – then anyone in the co. may be liable"

NOTE: IN MOST CASES, DON'T NEED TO LOOK AT PIERCING, JUST LOOK AT CA.

**Can the CL be used to impose liability?**

Often through law of agency (person acted as company's agent) or negligence (duty of care b/w company and victim)

**Try to fit case within existing case law regarding lifting the veil – highly unlikely to succeed**

Equitable remedies may be awarded as in **Gilford Motor Co** (injunction) **Jones v Lipman** (SP) **Positive Endeavour v Madigan** (equitable damages)

NOTE: agency is not really veil piercing as it confirms 2 separate entities

## PIERCING THE CORPORATE VEIL AT COMMON LAW

- **Briggs v James Hardie**, Rogers AJA expressed courts' difficulty in lifting veil:
  - "...the threshold problem arises from the fact there is no common, unifying principle, which underlies the Courts' occasional decision to pierce the corporate veil. Although an ad hoc explanation may be offered by a court which so decides, there is no principled approach from the authorities."
- AUS courts reluctant to depart from the principle in *Soloman's* case and lift the veil
  - Very rare – no general instances
- Loose categories include:
  - a. Sham, fraud or improper conduct



- b. Agency (not truly lifting the veil – just using agency)
  - c. Corporate group enterprises
  - d. General interests of justice – often tortious acts
- Generally limited to the facts already ruled as lifting the veil – narrow application
- NOTE: do not necessarily ignore separate legal identity of a company but rather impose personal liability where it is necessary
  - AUS Courts tend to more strongly recognize separate legal entity than ENG

## MEMBERS' MEETINGS

- Different types:
  - Annual General Meeting (AGM)
  - Extraordinary General Meeting (EGM) – any other meeting
    - For approval of special matters such as:
      - Change of name
      - Change of company type
      - Mergers / acquisitions
      - Voluntary winding up
  - All members may be entitled to attend, but not necessarily to vote (eg voting and non-voting shares) → depends on constitution
  - Voting may be undertaken in person or by proxy (where discretion to vote is given to another to vote on your behalf)

### EGMs

#### Calling A Meeting

	Pty	Public
Who can <u>call</u> a meeting?	(i) Directors ( <u>s 249C</u> RR) <ul style="list-style-type: none"> <li>a. Mandatory for Ds to be able to call meetings for listed companies (<u>s 249CA</u>)</li> </ul> (ii) Court order ( <u>s 249G</u> ) <ul style="list-style-type: none"> <li>a. Often where it's impracticable to call the meeting in any other way</li> </ul> (iii) Members if they have 5% of voting power ( <u>s 249D/E</u> ) <ul style="list-style-type: none"> <li>a. <u>NOTE</u>: 100 SH signature rule abolished in March 2015</li> </ul>	(iv) Directors ( <u>s 249C</u> RR) <ul style="list-style-type: none"> <li>a. Mandatory for Ds to be able to call meetings for listed companies (<u>s 249CA</u>)</li> </ul> (v) Court order ( <u>s 249G</u> ) <ul style="list-style-type: none"> <li>a. Often where it's impracticable to call the meeting in any other way</li> </ul> (vi) Members if they have 5% of voting power ( <u>s 249D/E</u> ) <ul style="list-style-type: none"> <li>a. <u>NOTE</u>: 100 SH signature rule abolished in March 2015</li> </ul>
Who pays for the meeting?	<ul style="list-style-type: none"> <li>• Directors if called by them (<u>s 249E</u>)</li> <li>• Members if called by them (<u>s 249F</u>)</li> </ul>	<ul style="list-style-type: none"> <li>• Directors if called by them (<u>s 249E</u>)</li> <li>• Members if called by them (<u>s 249F</u>)</li> </ul>

#### Members Requesting a Meeting

	Pty	Public
Who can <u>request</u> a meeting?	>5% votes that may be cast (s 249D(1) – Ds will be then required to call a meeting (send notice)	>5% votes that may be cast (s 249D(1) – Ds will be then required to call a meeting (send notice)

	Meeting is convened when notice is distributed ( <i>NSX Ltd v Pritchard</i> )	Meeting is convened when notice is distributed ( <i>NSX Ltd v Pritchard</i> )
What form of request?	Request must be in writing, state any resolution to be proposed, be signed by the requesting members and be given to the company (s 249D(2))	Request must be in writing, state any resolution to be proposed, be signed by the requesting members and be given to the company (s 249D(2))

# 1) INTRO - HAS X BREACHED A DUTY?

## 1) State relevant parties and their potential breaches of duty

- Ds have managerial power in their company (**s 198A(1); Automatic SC**) but cannot breach their duties in exercising this power

## 2) Directors owe duties under various sources, all providing different remedies, such as:

- Statute – under provisions of CA
- Equity – fiduciary duties as D/Os (*Westpac v Bell*)
- Contract (*ASIC v Adler*) – only if relevant on the facts
- Company constitution = **s 140** – effect of a contract between the company, directors and each member – must be obeyed – breach = remedy
- Tort (*Daniels v Anderson*) – CL negligence – only for s 180(1)

## 3) Main statutory duties in ss 180-184 operate in addition to Ds general law duties (**s 185(1) CA**)

- EXCEPT ss 180(2) and (3), which supersede the common law (**s 185**)
- May be liable under both (*State of SA v Marcus Clark*) – separate remedies – mainly equity

## 4) These duties are owed to “the company as a whole” (*Parke; Percival*)

- NOT individual shareholders (*Percival v Wright; Coleman v Myers; Brunninghausen*)
- NOT potential investors (*ASIC v Maxwell*) only current shareholders
- NOT employees (*Parke v Daily News*)
- APPROACHING insolvency, to consider creditors’ interest (*Kinsela*)
  - Increasing tendency of Courts to intervene to protect Cs interests (*Westpac v Bell*)
- NOTE: Ds still have general power to manage the company under **s 198A**

## 5) What are the relevant persons’ roles in the company?

- Some sections apply to directors/officers/employees/all – so need to ascertain role

## 6) Identify and analyse most appropriate statutory rules?

- Use facts/statute/CL to determine – ss 180-4, 588G, 191, 195

## 7) Is anyone involved in the contravention (**s 79**)?

- (a) aided, abetted, counselled or procured the contravention; or
- (b) induced, whether by threats or promises or otherwise, the contravention;
- (c) been in any way, by act or omission, directly or indirectly, knowingly concerned in, or party to, the contravention; or

- (d) conspired with others to effect the contravention
- Only relevant for sections 181 (**s 181(2)**) – 182 (**s 182(2)**) – 183 (**s 183(2)**)
  - If involved then liable for same penalties

## 8) Defences

## 9) Remedies

# 1A) IS X A DIRECTOR?

- “**Director**” of a company means:
  - Person appointed to position of director (**s 9(a)(i)**)
  - Unless contrary intention appears, a person who is not validly appointed as a D if (**s 9(b)**):
    - (i) they act in the position of a director (DE FACTO); or
    - (ii) the directors of the company are accustomed to act in accordance with the person's instructions or wishes (SHADOW)
  - NOTE: must also satisfy requirements under **s 201B**
- “**Officer**” of a corporation means (**s 9 CA**)
  - (a) a director or secretary of the corporation; or
  - (b) a person:
    - (i) who makes, or participates in making, decisions that affect the whole, or a substantial part, of the business of the corporation; or
    - (ii) who has the capacity to affect significantly the corporation's financial standing; or
    - (iii) in accordance with whose instructions or wishes the directors of the corporation are accustomed to act
      - Excluding advice given by the person in the proper performance of functions attaching to the person's professional capacity or their business relationship with the directors or the corporation
- NOTE: if not D then very likely to be an O – lower threshold (as in **Grimaldi**)

## IF X IS NOT SPECIFIED AS A DIRECTOR

- ASIC/Claimant bears onus of proving X is a SD or DFD (**s 9**) – may be both (**Buzzle v Apple**)
- SHADOW DIRECTORS = real but not nominated controller of a company (Puppeteer – Obeid)
  - No need for involvement in all transactions, only that Board is accustomed to act in accordance with their directions (**ASC v AS Nominees; Deverell**)
    - IE. Have control when they desire it
  - May be another company or even a major shareholder (**Antico**)
    - BUT commercial, arms length dealings DO NOT make a company SD (**Buzzle**)
      - IE. May impose conditions as part of ordinary dealings and still be in a commercial relationship
- DE FACTO DIRECTORS = not appointed as a director but still act as one (**Drysdale**)

- Continues to perform their role after termination of directorship (***Mistmorn v Yasseen***)
- Attends board meetings and has their opinion factored into decision making (***Austin v Spencer***)
- Controls direction of the company or is a driving force within it (***Harris v S***)
- EG: consultant to mining company in management role was DFD (***Grimaldi v Chameleon***)
  - IE. Managed assets, recommendations followed, had office = D in all but name
- NOTE: assess the conduct/position of the person to determine if they are shadow/de facto Ds
  - Person must act in a manner that is distinctive of a director (***DCT v Austin; Antico***)
  - Determine where the locus of the decision making is (***Finn in ASC v AS Nominees***)

## 2a) BREACH OF DUTY – CARE/SKILL?

### THE GENERAL LAW DUTY

- NOTE: this is only as a background – replaced by operation of statute
- Directors have a general law duty to exercise reasonable care, diligence and skill (***PBS v Wheeler; AWA v Daniels; Daniels v Anderson***)
  - Imposed both at CL/equity BUT NOT a fiduciary duty
  - Supplemented by statutory duties in ss 180-183
- TEST = Did director act in a manner consistent with what a reasonable man of ordinary prudence would do in the circumstances? (***Daniels v Anderson; Re Brazilian Rubber Plantations***)
  - Determined by balancing the foreseeable risk of harm against the potential benefits reasonably expected to accrue to the company from the conduct (***ASIC v Doyle; ASIC v Vines***)
    - Was the jeopardy for the company outweighed by potential benefits and were there reasonable steps that could have been taken to avoid the jeopardy (***ASIC v Maxwell***)
- ***AWA v Daniels*** = Auditors and executive directors liable in negligence for failing to implement effective internal controls to monitor risks
  - Lesser standard imposed on NED as they were entitled to rely on advice EDs/auditors
  - Directors' obligations should be assessed objectively
- ***Daniels v Anderson*** = upheld NSWSC – duty involves becoming familiar with business of the company, how it is run and ensuring it has means to audit the company to ensure it is properly run
  - Must take reasonable steps to put themselves in a position to guide and monitor the management of the company
- ***ASIC v Maxwell*** = non-executive director did not breach his duty when he left the conduct of capital raising to qualified fellow directors supported by legal and accounting advisers while he supervised the company's building construction work
- ***ASIC v Warrenmang*** = director did breach his duty when, as the "sole controlling mind" of the company and sole signatory to the company's bank account, he exposed the company to

breaches of the Act by failing to hold capital raised under an undersubscribed fundraising in a separate trust account and return it upon request

- **S 180(1)** A director or other officer of a corporation must exercise their powers and discharge their duties with the degree of care and diligence that a reasonable person would exercise if they:
  - a) were a director or officer of a corporation in the corporation's circumstances; and
  - b) occupied the office held by, and had the same responsibilities within the corp. as, the D/O

## **1) MUST BE A DIRECTOR OR OFFICER**

- Must fall within the definition under s 9 OR be a de facto/shadow director (see above)

## **2) WAS THERE A BREACH OF STANDARD OF CARE?**

- Objective Test = D/O must exercise degree of care/diligence reasonably expected of any D/O possessing the same level of knowledge/expertise/experience (***Re City Equitable Fire; ASIC v Rich***)
  - Essentially relates to Ds negligence (***Vrisakis***)
  - Must balance the potential harm and benefit to co. (***Vines***)
  - IE. Higher level of skill, higher the standard expected
- Consider “corporation’s circumstances” which requires assessment of (***Rich; ASIC v Maxwell; AWA***)
  - Type of company – including if listed on financial market
  - Distribution of work/responsibility between board and executives (***ASIC v MacDonald***)
  - Composition of the board (***DCT v Clark***)
  - Size and nature of its business
  - Terms of its constitution
  - Whether or not company controlled by a parent company

## **3) LOOK AT SPECIFIC POSITIONAL DUTIES/CASES?**

NOTE: use this to situate their position/expertise/experience for the objective test (above)

### **DIRECTORS:**

- Cannot be sleeping D – cannot focus on their area of skill – must have rudimentary understanding of all company business (***AWA Cases; ASIC v Adler***)
- Take all reasonable steps to guide/manage the company (***Daniels v Anderson per Santow***)
- Maintain familiarity with the financial status of corporation by regularly reviewing financial statements (***CBA v Freidrich; ASIC v Adler***)
- Cannot shut their eyes to corporate misconduct, then claim that because they did not see it, they had no duty to inquire (***Daniels v Anderson per Clarke & Sheller JJA***)
- Keep the Board constantly informed about potential problems as soon as possible (***Daniels v A***)
- Even sleeping/non-involved Ds failure to participate in management = liability (***DCT v Clark***)

### **NON-EXECUTIVE DIRECTORS:**

- Standard expected is exactly the same as executive D’s (***ASIC v Rich*** (Greaves); ***ASIC v Healey***)
  - Cannot simply rely on others such as auditors/lawyers (***ASIC v MacDonald***)