

TOPIC 3 – CONSTITUTION AND REPLACEABLE RULES

3.1 Internal Governance Rules

Internal governance rules for SHs and directors are found predominantly in the constitution and RR. These are the legal mechanisms that we have to determine the rules between members and directors internally

*All rules apply to private companies unless they change them in the constitution, some rules are mandatory for public companies.

- **We now have S134 CA which tell us that a:** company's internal management may be governed by the replaceable rules, a constitution or by a combination of both.
- (Sets a hierarchy of rules) Note **s135(2)**: The company's constitution can displace or modify a replaceable rule - i.e. This section establishes that if there is conflict, then the constitution will prevail.
- Replaceable rules literally mean that you can replace them – they are rules found in the Corporations Act that you can adopt if you want them (do nothing and they will apply to you) or if you don't like them and want them to apply differently to your company you can change them
- You change a replaceable rule by a constitution

3.2 Replaceable Rules

S135 splits replaceable rules into two categories (some RR apply to all companies, others not)

Replaceable rules that may be applicable to ALL companies (i.e. default rules, can do away with them in the constitution):

- **S135(1)(a)(i)**: applies to companies registered after 1 July 1988
 - Does not apply to sole director/member companies
 - Different RR may apply to different companies, e.g. public or proprietary
- **S141** includes the complete list of RR! – if you want to know if there is a rule in the CA that a company can change go to s141 – always have this section when you are looking at a particular rule that applies to a company to check if it is a normal legislative rule that applies to everyone or if it is an RR

Replaceable rules that are replaceable for Pty (private company) but mandatory for public

- Always need to know if it is a private or public company because that will tell you how these rules apply
- For public company these rules operate like normal legislation and cannot be changed
- Private companies may change these rules
- Rules which are replaceable rules for proprietary companies and mandatory rules for public companies (i.e. cannot be altered by the constitution of public companies) - **s135(1)(b)**
- They apply as an 'ordinary provision' of the Corporations Act to public companies **s135(1)(b)(iv)**

Why would a company adopt a constitution?

- Generally, incorporator's choice
 - RR have a bias towards Ptys (they have been written largely with private companies in mind) so if you have a public company you may want to change the RR
 - RR are not really suitable for a company with equal shareholders or in situations where a particular shareholder enjoys certain rights
 - The RR are not sufficient for a company that wishes to issue different classes of shares or for a company that proposes to issue partly paid shares
- If it is a RR that talks about how you are going to run the company you may have your own specific preferences that you do not want the CA to tell you how to run your company
- If RR changes you then need to follow the amended RR (parliament changes how you run your company in that matter) or you can have a constitution which will prevail over the amendment
- Some companies must adopt a constitution:
 - Companies that wish to be listed on the ASX
 - No liability company constitutions must state its sole purpose is mining and that the company has no contractual right to recover from a shareholder who fails to pay them - **s112**
 - Public companies limited by guarantee that wish to seek an exemption from ASIC to omit the word
 - 'limited' or 'ltd' from the company's name will need to have a constitution that states its objects are to pursue charitable purposes only - **s150(1)**

How to Adopt a Constitution

s136(1): a company adopts a constitution:

- (a) On registration (if each member specified in the the company's registration agrees in writing to the terms of a constitution before the application is lodged); or
- (b) After registration (if the company passes a special resolution adopting a constitution or a court order is made under s233 that requires the company to adopt a constitution) - special resolution means at least 75% of the vote at a general meeting as per **s9**)
- A copy must be provided to a member upon request - **s139**
- For public companies there are additional lodgement requirements with ASIC: **s136(5)** and **s138**

3.3 Company Powers, Objects Clauses and the Abolition of Ultra Vires Doctrine

Abolition of Ultra Vires Rule

- Up until 1984, required inclusion of objects clause in CC (purpose the company was created for)
- Ultra Vires doctrine: if a company acted beyond the power conferred under its constitution, the act was invalid.
- Statutory amendments in 1984: objects clause became optional.
- Companies now have full capacity (all powers of an individual) as they don't have to restrict their objects - **s124**

Current Restrictions on the Objects Clause

- **125(1):** a company's constitution can restrict the exercise of any of the company's powers (i.e. its contractual capacity), but the **exercise of such power by the company is not invalid merely because it is contrary to such restrictions**
- **125(2):** a company's constitution may set out the company's objectives, but an act of the **conduct is not invalid because its contrary to or beyond any objects in the company's constitution**
- While the acts may not be void, some consequences may follow (directors may be found to have breached their duties or the conduct in question may be deemed to be oppressive)
- AKA if a company has a constitution that includes restrictions/objects the exercise of power by the company is not invalid just because it is contrary to those object or restrictions (act continues to be valid)
- If you engage with a corp acting outside its objects you do not have to worry that the act will be undone
- Shareholders set out what is in the constitution. Unfair to the SHs that acts against the constitution are valid – however they could have other remedies (like going after the director)

3.4 Constitution as a Statutory Contract

The constitution and RR (mechanisms governing how directors and shareholders engage with each other) operates as a Statutory Contract.

Contractual Effect of the Internal Governance Rules

- Rules that govern the way a company acts are replaceable rules and the constitution

s140(1) tells us how these rules operate between various internal parties to a corporation and provides that the replaceable rules and the company's constitution have effect as a contract between:

1. The **company and each member** – **s140(1)(a)**
 2. the **company and each director and company secretary** – **s140(1)(b)**
 3. a **member and each other member** – **s140(1)(c)**
- The terms covered by s140 are not treated as ordinary provisions of the Corporations Act, but rather a **'statutory contract'** between the relevant parties (slightly different from normal contract)
 - Each agrees to observe and perform the constitution and RR so far as they apply to that person
 - These rules tell us what parties can and can't do when interacting with each other - if they breach any of these rules then you have a contractual claim

Contract between the Company and Each Member

- Contractual rules between the company (as a legal entity) and each shareholder
- A company can take action against a member to force them to comply with the provisions in constitution or RR
- **Hickman v Kent or Romney Marsh Sheep Breeders Association (1915):** constitution provided that disputes between company and a member would be referred to arbitration. Hickman started legal action which the court

stayed on the basis that the statutory contract was binding and therefore had to refer dispute to arbitration (company succeeded in enforcing obligation)

- **Members can also take action to enforce provisions against the company if the company breaches a provision** - i.e. **s250E(1)** where you have a vote at a general meeting: one vote per shareholder in show of hands OR on a poll (counted by the amount of shares owned) – if the company says at a meeting that you can't do this then you can take action against the company under the statutory contract provision
- **Hurdle:** members cannot enforce provisions that confer rights in **capacity other than that of member** - e.g. **Eley v Positive Government Security Life Assurance Co Ltd (1875)**: held that statutory contract was a contract only between the persons referred to in the CA and could not create rights or impose duties on outsiders. In this case, there was an **outsider right because it was not one that related to Mr Eley's capacity as a member of the company but rather a solicitor.**
- E (solicitor and SH) drafts a CC including a provision that he is the company's permanent solicitor. So this contract (relating to his role as a solicitor/third party) is between a company and a member but he could not bring a claim under s140 as the contract is between a solicitor and a company but the statutory contract relates to company and member

Contract between Company and Directors/Secretary

- Operates in the same way as the previous contract just with 2 different parties now
 - RR and rules in the constitution that relate to directors/company secretary's
 - Only provisions in a company's constitution that apply to such officers will have effect as a statutory contract
 - Examples of powers of directors to enforce as a contract: (rules regarding all of these matters)
 - **S198A** (powers of directors)
 - **S201G** (company appointing director)
 - **S201H** (directors may appoint other directors)
 - **S202A** (director remuneration)
 - **S204F** (terms and conditions of secretary appointment)
 - Directors will commonly have separate contracts of service that are independent of the company's constitution
 - Note, the company may alter a constitution provision and this may have the effect of extinguishing right of director and shareholder - particularly relevant for director removal - **Shuttleworth v Cox Bros & Co (Maidenhead) Ltd (1927)**: court held that company which changed constitutional provision appointing director for life was not in breach of equivalent of s140(1)(b)
 - E.g. CC says the company cannot remove a specific director and the company then tries to remove the director this is potentially a breach of the statutory contract terms
 - However, if members vote to change the CC, getting rid of the provision then SHs can remove the director without breaching a statutory contract
- *So don't just breach the statutory contract, change the constitution and change the contract

Contract between a Member and Each Other Member

- Important where a CC contains a pre-emption clause
- Pre-emption clause: gives SHs a right of first refusal to buy other shareholder's shares
- If you try to sell shares without first going to other SHs you may be in breach of your member-to-member statutory contract
- Registration of transfers of shares effected in breach of a pre-emption clause is void and the register will end up being corrected under **s175**
- **Re Caratti Holding Co Pty Ltd**: one of the clauses in the company's constitution empowered the majority shareholder to compulsorily acquire shares of a minority shareholder. WA SC held there was a contractual right under predecessor of s140(1)(c) to enforce compulsory acquisition

Consequences of a breach - Contractual Effect

- **S135(3)** makes it clear that a failure to comply with the 'statutory contract' is not itself a contravention of the Act, rather the **breach is contractual in nature rather than statutory**
- However, it cannot be treated exactly like a normal contract because:
 - Members who join the company will be bound even if they don't sign a physical contract
 - There are limitations on enforcement and remedies