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1 HOW DO CORPORATIONS WORK?

1.1 TYPES OF BUSINESS ASSOCIATIONS

EXAM: Be conscious of company names and whether that indicates a public/proprietary company

- ~ Pty Ltd = proprietary (limited)
- ~ Pty = proprietary (unlimited)
- ~ Ltd = public
- ~ NL (No Liability) = public

All references to legislation are to the *Corporations Act 2001* (CA) unless otherwise indicated.

1.2 SEPARATE LEGAL ENTITY AND LIFTING THE CORPORATE VEIL

1.2.1 SEPARATE LEGAL ENTITY

The *Salomon* decision established the company as an independent person with its rights and liabilities appropriate to itself, and that “the motives of those who took part in the promotion of the company are absolutely irrelevant in discussing what those rights and liabilities are”.

Lee v Lee’s Air Farming Ltd found that an individual can be a director and an employee of the company.

1.2.2 PIERCING/LIFTING THE CORPORATE VEIL

GENERAL RULE: There is NO common unifying principle to identify when to pierce the veil i.e. neither exclusive nor exhaustive categories (*Prest v Petrodel Resources Ltd*)

BUT CL has recognised the following circumstances -

1. Where the corporation was formed as an instrument for **fraud/sham/improper conduct** (*Gilford Motor Co Ltd v Horne*)
 - Examples -
 - To mask the effective carrying on of a business
 - To avoid contractual obligations/penalties (*Gilford Motor Co Ltd v Horne*; *Garbutt Business College Ltd v Henderson Secretarial School Ltd*)
 - See *Jones v Lipman*; *Re Darby*
 - **NOTE:** Agency (i.e. where the company, in reality, is acting as agent of another entity (e.g. a company) usually within a group) does NOT constitute a circumstance where the corporate veil can be pierced (*ACN 007 528 207 Pty Ltd (in liq) v Bird Cameron (Reg)*)
 - **NOTE:** Tort does NOT constitute a circumstance where the corporate veil can be pierced (*Briggs v James Hardie & Co Pty Ltd*)
2. **Statutory disregard**
 - Insolvent Trading
 - **588G CA:** Where debts are incurred by company while it is insolvent/its solvency is impaired by incurring that debt, directors will be personally liable for those debts where they knew/ought to have known of the insolvency
 - **588V-X:** Where a company is a subsidiary of another company, that holding company may also be made liable in relation to those debts where it knew/ought to have known of the state of its financial affairs
 - Employee entitlement contributions
 - **Pt 5.8A and Corporations Amendment (Strengthening Protections for Employee Entitlements) Act 2019 (Cth)**

Example:

The question to be asked is whether shareholders can pierce the corporate veil of Z Ltd such that Z Ltd is liable to the shareholders. The potential ground that the corporate veil can be pierced is fraud.

Using the principles set out by Atkinson LJ in *Smith, Stone and Knight Ltd*:

- Were the profits treated as profits of the parent company?
 - Since there was only a reference to dividend payments and not profits, it would not be treated as profits.
 - An argument can be made that the BOD bragging that they can access all the funds of the new company and use all that money that Z Ltd is making from the insurance business without the liability goes towards the fact that the funds constitute profits.
- Were the persons conducting the business appointed by the parent company?
- Was the company the head and brain of the venture?
 - Z Ltd appointed all directors of Y Ltd (its subsidiary)
 - Z Ltd devised policies of Y Ltd

- Did the company govern the adventure, decide what should be and what capital should be embarked on the venture?
- Did the company make the profits by its skill and direction?
- Was the company in effectual and constant control?
 - Z Ltd appointed all directors of Y Ltd

In *Gilford Motor*, the new company was formed to mask the effective carrying on of the business of the old company. This case can be used to show the ____ department collapsing to show how Y Ltd was being used as an instrument of fraud to shield Z Ltd from liabilities.

In conclusion, Y Ltd is acting as an agent on or behalf of Z Ltd and the Court can pierce the veil, granting an injunction against the directors of Z Ltd and Z Ltd itself.

Example:

The company is a proprietary limited company. It is limited by shares and not guarantee, since proprietary companies cannot be limited by guarantee.

Under s 124, and as per the *Salomon case*, the company is a separate legal entity and as such it has perpetual succession. Its existence is not affected by the death of the shareholders/directors. As per s 119, the company will continue to exist until it is deregistered.

The company still needs 1 secretary (s 204A) and 1 director. The executors of the deceased's will have the responsibility of new members / directors – if no new members or directors can be found, control of the company will revert to the state and be deregistered. Alternatively, the executors may be able to wind up the company

1.3 CORPORATE CONSTITUTION

1.3.1 SOURCE OF INTERNAL RULES

Definition: Internal management rules govern the r/s between the company and each member, between the members among themselves, and between the company and each of its officers.

A corporation can elect to:

1. Function WITHOUT a constitution, relying solely upon the **replaceable rules**
2. Adopt its own constitution to displace/modify the replaceable rules wholly or in part (**s 136**)

136(1)(a)	If adopted on registration, each person specified in application must agree in writing to the terms before the application is lodged
117(3)	As a public company, it must lodge a copy of the company's constitution with the application for registration
136(1)(b)	After registered, it may adopt a constitution by passing special resolution

3. If it was incorporated prior to 1998, it may retain its memorandum and articles of association as the constitution of the company

Replaceable Rules

135	<p>Companies to which replaceable rules apply</p> <p>(1) A section or subsection (except subsection 129(1), this section and sections 140 and 141) whose heading contains the words:</p> <ol style="list-style-type: none"> (a) replaceable rule --applies as a replaceable rule to: <ol style="list-style-type: none"> (i) each company that is or was registered after 1 July 1998; and (ii) any company registered before 1 July 1998 that repeals or repealed its constitution after that day; and (b) replaceable rule for proprietary companies and mandatory rule for public companies --applies: <ol style="list-style-type: none"> (i) as a replaceable rule to any proprietary company that is or was registered after 1 July 1998; and (ii) as a replaceable rule to any company that is or was registered after 1 July 1998 and that changes or changed to a proprietary company (but only while it is a proprietary company); and (iii) as a replaceable rule to any proprietary company that is or was registered before 1 July 1998 that repeals or repealed its constitution after that day; and (iv) as an ordinary provision of this Act to any public company whenever registered. <p>...</p> <p>Company's constitution can displace or modify replaceable rules</p> <p>(2) A provision of a section or subsection that applies to a company as a replaceable rule can be displaced or modified by the company's constitution.</p> <p>Failure to comply with replaceable rules</p> <p>(3) A failure to comply with the replaceable rules as they apply to a company is not of itself a contravention of this Act (so the provisions about criminal liability, civil liability and injunctions do not apply).</p>
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1.3.2 EFFECTS OF THE CONSTITUTION

140	<p>Effect of constitution and replaceable rules</p> <p>(1) A company's constitution (if any) and any replaceable rules that apply to the company have effect as a contract:</p> <ol style="list-style-type: none"> (a) between the company and each member; and (b) between the company and each director and company secretary; and (c) between a member and each other member; <p>under which each person agrees to observe and perform the constitution and rules so far as they apply to that person.</p>
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1.3.3 ALTERATION OF THE CONSTITUTION

GENERAL RULE: Any modifications or repeal of the constitution will need to be "by special resolution" - a requirement that it be passed by at least 75% of votes (**s 136(2)**)

9	Special resolution amending the constitution comes into the effect the day it is passed or a date specified in the resolution
136(5)	A public company which amends/adopts the constitution must lodge a copy of the special resolution to ASIC

Limits to Altering the Constitution

GENERAL RULE: the Constitution is freely alterable and “mere fact that the alteration may prejudice or diminish the rights of some shareholders is not necessarily a ground for attacking the company’s exercise of its basic right to alter the constitution” (*Peter’s American Delicacy v Heath*)

- Any regulation/article purporting to deprive the company of this power would be invalid on the ground that it is contrary to statute (*Russell v Northern Bank Development Corp Ltd*)

BUT there can be some limits imposed such as:

<p><i>Entrenchment through further requirement</i></p> <p>Definition: by specifying the type of further requirement for its alteration which provision may not itself be repealed until such requirement is satisfied (<i>s 136(3)</i>)</p> <ul style="list-style-type: none"> E.g. CA requirement that resolution be passed with >75% consent of a particular person or condition be fulfilled Important device to control management/operations in companies where individuals wish to retain the power to veto 	<p><i>Statutory Entrenchment</i></p> <p>Definition: legislative limits on the power to alter a constitution</p> <ul style="list-style-type: none"> E.g. members cannot take up more shares, increase their liability or agree to increased restrictions Court will overturn any special contract w/ regard to increased liabilities could through a constitutional amendment w/o written consent (<i>Ding v Sylvania Waterways Ltd</i>)
<p><i>Class Rights</i></p> <p>Definition: where there may be altering class rights, there are additional protections for class of members whose rights are being varied</p> <ul style="list-style-type: none"> Distinction between (1) variation to class rights (NOT ALLOWED) and (2) variations to the enjoyment of rights If a proposal wishes to do so, the applicable class rights variation procedure + passing of special resolution has to be followed Default condition is written consent of >75% members unless there is a precondition specified in constitution 	<p><i>Entrenchment through weighted voting</i></p> <p>Definition: Used to augment voting powers of shareholders either generally or in relation to specific resolution</p> <ul style="list-style-type: none"> Restriction to prevent the passage of other resolutions (<i>Bushell v Faith</i>) Listed companies not allowed to have such trade
<p><i>Fraud on the minority and oppression</i></p> <p>Definition: invalid if it amounts to ‘fraud on the minority’ is oppressive/unfairly prejudicial/unfairly discriminatory against members</p>	

Effect of Altering the Constitution: Any rights vested in members/officers contained in constitution are vulnerable to amendment through alteration of constitution itself (see *Bailey v NSW Medical Defence Union Ltd*)

1.4 DIRECTORS' POWERS AND MEETINGS

1.4.1 WHO IS A DIRECTOR?

Appointment

A has been appointed a director (s 9AC(1)(a)(i)).

De facto director

Since A has been given powers and functions that would lead a reasonable third party dealing with him/her to believe he/she was a director, and he/she acts like a director, and others share in that mistaken belief, he/she will be deemed to be a director (s 9) (*Grimaldi*)

Shadow director

Even if A is not involved in every, or even most, transactions undergone by the company, he/she has strategic control, that is, control when desired (*ASC v AS Nominees*). This is enough to prove the existence of a director per s 9.

Factors that indicate shadow director:

- Largest shareholding compared to the next significant holder (*Standard Chartered Bank of Australia Ltd v Antico*)
- Financial reporting standards imposed on this company same as those imposed on all companies in the group (*Standard Chartered Bank of Australia Ltd v Antico*)
- Decisions regarding funding and security interests was effectively decided by A and accepted by the company (*Standard Chartered Bank of Australia Ltd v Antico*)
- BOD were often asked to act partially to A or act in ways that required the dereliction of their own and of their trust company's duties (*ASC v AS Nominees*)
- A sacked the whole board of one company when they did not agree with him/her (notwithstanding his/her lack of power to do so) and none of the BOD questioned his/her power to do so (*ASC v AS Nominees*)

Example:

Is A a 'director' under the extended definition in s 9?

- He/She is certainly participating in decision-making and is influential, lending to the fact that he/she might be a 'de facto' director (*Chameleon Mining*) or shadow director (*Pioneer Concrete*).
- A sent all board papers, has meetings about Z Ltd's business with B and C, and is conducting a dimension of Z Ltd's customer recruitment by bringing in high-rollers.
- It seems that the Board does/does not approve freely and as founder he/she dominates/does not dominate them.
- A was at the strategy retreat and contributed to the decision to carry on Z Ltd's business as usual.

Example:

The first question is whether A was validly appointed as a director of Z P/L.

- Section 201H(2) of the CA states that after a person is appointed as a director, the company must confirm the appointment by resolution within 2 months.
- In this case, the company failed to confirm the appointment by resolution of the 2 month appointment. Therefore, she/he has not been validly appointed.

Then consider whether A was a de facto or shadow director of Z P/L. / In the time that he/she is waiting to be confirmed, consider whether A was a de facto director.

- Per s 9, a person who is not validly appointed by will nevertheless be deemed to be a director if they act as such.
- A attended all director meetings, essentially performing tasks that would have been performed by a director. She is a de facto director.
- Next considering what everyone else was doing based on the fact that she was director...
- Since there was no facts indicating what everyone else was doing based on the fact that she was director, she is unlikely to be a shadow director.

Thus, A can be sued because he/she is a de facto/shadow director.

1.4.2 APPOINTMENT AND APPROVAL OF DIRECTORS