

CORPORATE LAW NOTES

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Lecture 1 - Development of corporate law in Australia; Contextual issues and business structures

OVERVIEW

- The range of business structures
- Rationale for forming companies
- Stakeholders of companies
- Types of companies and the corporate life cycle
- Internal management of companies
- The development of corporate regulation in Australia
- Themes throughout corporate law
- Tips for studying Corporate Law

The range of business structures

- Sole trader
- Partnership:
 - Defining partnership
 - Identifying a partnership
 - Distinguishing partnerships from Joint Ventures
 - Rights and obligations of partners
 - Liabilities of partners
 - Termination of partnerships
- Associations – Incorporated and unincorporated
- Cooperatives – Autonomous self-help organisations controlled by members for their mutual benefit
- Trusts - Equitable relationships where a trustee holds (and may manage) property for the benefit of beneficiaries)

Identifying partnerships

- **Partnership Act 1892 (NSW)** s 1(1): “Partnership is the relation which exists between persons carrying on a business in common with a view of profit . . .”
- Equivalent Partnership Acts in other Aust jurisdictions
- PA s 2(1) - Rules for determining existence of p/ship:
- “Regard shall be had to ...
 - Ownership of property
 - Sharing of gross returns
 - Sharing of profits”
- However – these factors must be considered in light of the surrounding facts → Courts look to the substance of relationships
- But – Profit sharing **alone** not determinative of a partnership
- Employees – sharing profits with an employee does not make the employee a partner – PA s 2(3)(b)
- Loans – A creditor taking a share of profits - interest due on a loan - does not become a partner – PA s 2(3)(d)

Joint Ventures

- Two or more parties cooperating with each other to undertake a particular project (eg mining project, infrastructure, new products etc)
- Each party contributes special expertise
- Parties often try to classify commercial relationships as JVs rather than partnerships → to avoid the imposition of fiduciary obligations and the extensive restrictions and liabilities under the Partnership Acts
- However → Courts look to the substance of the relationship - as the following cases show

Canny Gabriel Castle Jackson Advertising Pty Ltd v Volume Sales (Finance) Pty Ltd [1974] HCA 22

- 4th Media and Volume Sales – JV agreement to promote a concert
- JV agreement stated: (i) they would share the profits equally; (ii) the JV would be based only on their mutual agreement and (iii) any disagreements would be settled by arbitration
- Also – gave undertakings re their respective financial stability
- 4th Media – later granted Canny Gabriel rights on ticket sales - security for other debts
- Were 4th Media and Volume Sales **in a partnership – even though their agreement stated they were in a JV?**
- If so, Canny Gabriel's rights to ticket sales would take second place after Volume Sales' rights as a partner to equal share in \$\$
- Held: 4th Media and Volume Sales were partners → The nature of the obligations – showed the business was being conducted with **mutual concern** for one another

United Dominions Corp Ltd v Brian Pty Ltd [1985] HCA 49

- UDC and Brian – members of a property development JV with SPL
- Prior to forming this JV – UDC and SPL entered into a contract involving the proceeds of the future JV if SPL failed to repay \$\$ lent to it by UDC
- Brian – was unaware of the contract between UDC and SPL
- During the course of this JV UDC took all of the profits and relied on the previous contract – as SPL had indeed failed to repay the \$\$
- Brian – alleged this was a breached the fiduciary relationship between the joint venturers → The JV agreement stated they were Joint Venturers – not partners
- Did a fiduciary relationship exist between UDC and Brian even though they were in a JV?
- Held: Fiduciary relationship between UDC and Brian → Despite wording of the JV agreement – there was a partnership (profit sharing) between the joint venturers → Ordered UDC to pay Brian its share of the JV profits

Re Megevand; Ex parte Delhasse (1878) 7 Ch D 511

- Merely calling a transaction a “loan” will not prevent the relationship being characterised as a partnership
- Megevand and his business partner – borrowed \$\$ from a Delhasse
- Contract stated – transaction was a loan and Delhasse did not become a partner → But gave Delhasse the rights to:
 - Share in the profits and losses;
 - Receive regular financial statements about the business;
 - Examine the books of the business at any time;
 - Provide further \$\$ to the business if necessary; and
 - Terminate the business at any time
- Held: Delhasse was a partner – by virtue of the extensive rights the contract gave him – which were >> consistent with those of a partnership than a loan

- Purpose of the loan – to avoid liability of being a partner – But still giving Delhasse all rights and powers that partners usually have

Badeley v Consolidated Bank (1888) 38 Ch D238

- Agreement to provide funds for building a railway - Held to be a loan not a partnership
- Badeley – provided a loan to Smith (railway constructor)
- Smith - assigned his plant machinery etc as security
- Under the loan agreement - Badeley obtained the right to be paid 10% interest and profits
- Similar facts to Megevand – BUT – Badeley didn't have the right to terminate the business → Only to take it over if Smith became bankrupt
- → Similar to bank appointing a receiver
- Also - Badeley didn't share in the losses of Smith's business
- HELD: Genuine loan → NOT a Partnership

Goudberg v Herniman Associates Pty Ltd [2007] VSCA 12

- Work undertaken by persons who were in the planning stages of setting up an Australian franchise for a large American restaurant chain
- This work was found to be merely preparatory to carrying on a business
- The correspondence between the parties indicated that they were working to 'get the project off the ground' and, whilst several trips to the United States were undertaken – and whilst they were acting in common – and with a view to generating profit → They were not "carrying on a business"

Liability of partners

- PA s 5 – Power of partner to bind firm - s 5(1):
- "Every partner ... is an agent of the firm and of the other partners for the purpose of the business of the partnership ... the acts of every partner who does any act for carrying on in the usual way business of the kind carried on by the firm of which the partner is a member, binds the firm and the other partners, unless the partner so acting has in fact no authority to act for the firm in the particular matter, and the person with whom the partner is dealing either knows that the partner has no authority, or does not know or believe the partner to be a partner"
- PA s 6 – Partners bound by acts on behalf of firm
- PA s 9 – Liability of partner → Partners jointly liable for debts and obligations incurred whilst they are partners
- PA s 10 – Liability of firm for wrongs → "... acting in the ordinary course of the business of the firm, or with the authority of the partner's co-partners"
- PA s 12 – Liability for wrongs joint and several

Polkinghorne v Holland [1934] HCA 28

- "Ordinary course of business"
- Mr Holland - a partner of a 3 member law firm - gave poor investment advice to Ms Polkinghorne - a client of the firm
- He advised her to sell government securities – and to invest in a company in which he was involved – which had no assets
- Holland – then disappeared with Ms Polkinghorne's \$\$
- After the investment failed – Ms Polkinghorne sued the whole firm of solicitors for compensation for the poor advice she had received
- Issues – Was firm responsible for advice provided by Holland? → Was the investment advice provided by Holland "in the ordinary course of business"?

- Held: Yes the law firm was responsible – because Holland had an obligation to advise all clients to seek appropriate financial advice – this obligation occurred in the ordinary course of the law firm's business → Holland failed to fulfil this obligation

Dubai Aluminium Co Ltd v Salaam [2002] UKHL 48

- A law firm partner had drafted sham contracts to enable a client to improperly obtain substantial commissions from Dubai Aluminium Co Ltd
- Dubai Aluminium – was induced by fraudulent means to pay US\$ 50m in a series of fake consulting agreements drafted the partner
- The partner – was not authorised by his firm to engage in such conduct
- Dubai Aluminium – sought to make the law firm vicariously liable for the dishonest partner's actions under the *Partnership Act 1890* (UK)
- Issues: (1) Did the errant partner's wrongful conduct in drafting the sham contracts occur "in the ordinary course of" the firm's business? → And if so (2) Was the firm vicariously liable for the partner's fraudulent actions?
- Held: The drafting of the agreements was an act done within the ordinary course of the firm's business (which involved providing legal services) – even though they were done for a fraudulent purpose → Hence the partner was acting in the ordinary course of the firm's business → not "on a frolic of his own"
- Followed in *Hraiki v Hraiki* [2011] NSWSC 656 at [83] – [84]

Obligations of partners

- PA s 20: Partnership property must be held and applied for the benefit of the firm
- PA s 28: Duty of partners to render accounts
- PA s 29: Accountability of partners for private profits
- PA s 30: Duty of partner not to compete with firm

Birtchnell v Equity Trustees Executors & Agency Co Ltd [1929] HCA 24

- The Birtchnells – sued Equity Trustees – Executors of the estate of a Mr Porter – who (before his death) was a partner in their real estate business
- Birtchnell – alleged Porter had received a secret commission from one of their firm's clients in a land sub-division handled by the firm → Sought their share of the secret commission as partners of Mr Porter
- Was Mr Porter's conduct in receiving the secret commission in breach of his fiduciary obligations as a partner of the firm before his death?
- Held: Mr Porter's conduct (obtaining a secret commission from a land sub-division) was within the scope of the real estate firm's activities → the real estate firm had occasionally engaged in land development activities
- Also – the scope of a fiduciary's obligations will be determined by the nature of the relationship between the fiduciary and the principal → which may include (i) any contract; and (ii) the range of activities undertaken by the firm → Need to look to the broader context

Dean v McDowell (1878) 8 Ch D 345

- MacDowell and Dean – Partners in a firm of salt merchants and brokers
- Partnership agreement – provided the business would last seven years
- Clause 8 – Required the partners to "diligently and faithfully employ themselves in and about the business of the partnership, and carry on and conduct the same to the greatest advantage of the partnership"
- Clause 11 – Prohibited the partners from engaging "directly or indirectly in any trade or business except upon the account and for the benefit of the partnership"
- Agreement – Allowed Dean to engage in "any other trade or business if he shall think fit"

- After the partnership had expired - the partners discovered MacDowell had been a partner in a firm of salt manufacturers - which had become very profitable → Sought an account of profits from MacDowell
- Held: Distinct businesses - No detriment suffered by the Salt merchants

Kak Loui Chan v Zacharia [1984] HCA 36

- Dr Chan and Dr Zacharia - Had been partners in a medical practice
- The lease on the premises of their surgery was due to expire
- Option to renew the lease had to be undertaken by both partners
- After dissolution - but before the winding up of the partnership - Chan sought to exclude Zacharia from practicing there by taking up a new lease in his own name alone → And hence continuing the medical practice on his own
- Held - Dr Chan had breached his fiduciary duty - abusing his fiduciary position as a trustee and former partner to seek an advantage for himself - failed to act with fairness and good faith → Hence accountable to Dr Zacharia for the private profit he gained (**Account of profits**)
- Fiduciary obligations between partners - may continue even after the firm's business has ceased trading

Termination of partnerships

- Partnerships may be terminated by:
 - PA s 32: Dissolution by expiration or otherwise
 - If entered into for a fixed term, by the expiration of that term
 - If entered into for a single adventure or undertaking, by the termination of that adventure or undertaking
 - If entered into for an undefined time, by any partner giving notice to the other or others of the partner's intention to dissolve the partnership
 - s 33: Dissolution by bankruptcy, death, or change
 - s 34: Dissolution by illegality of partnership
 - s 35: Dissolution by the Court

Rationale for forming companies

- Limitations of the business structures discussed above
 - Liability; fundraising; succession
- Why do people form companies?
 - Separate legal personality - limited liability of members
 - Enables investment and business growth → Economic growth
 - Enables perpetual succession
- Companies (corporations) - have separate legal personality:
 - May enter into contracts
 - May employ people
 - May raise \$\$ ("capital")
 - May borrow, lend and invest \$\$
 - May sue and be sued (contract, tort and statutory liability)

Stakeholders of companies

- **Shareholders** ("members") - invest \$\$ (Capital) into companies → Receive shares (securities) in company → they therefore have equity in company (right to share in net worth of company)
- May sell their shares; may receive dividends
- **Directors** - Govern companies
 - In small "closely-held" companies - Directors often involved in management
 - In larger companies - Directors delegate management to managers and employees

- **Creditors** – Lend \$\$ to companies – creditors include financial institutions, companies and individuals
- Shareholders – may be categorised as:
 - Retail – individual investors
 - Institutional – Banks, insurance companies, superannuation funds, governments, fund managers
 - Contractors and business partners
- Employees
- Interest groups
- Community groups
- Increasing prevalence of Corporate Social Responsibility and focus on corporate culture
- Corporate law theories – Seek to explain how corporate law should balance these interests (Bottomley text Chapter 2)

Types of companies and the corporate life-cycle

- Over 2 million companies in Australia - Two main types
- Public (XYZ Ltd)
 - Larger-scale companies; Greater ability to raise funds
 - May apply to be listed (or “floated”) on financial markets (eg ASX) – the company’s shares may then be traded
 - Listed companies have more disclosure, reporting and compliance obligations
 - Other examples of public companies – Not-for-Profits; Registered clubs
- Proprietary (XYZ Pty Ltd)
 - Smaller scale companies; May be classified as Small or Large
- Corporate Groups
 - Parent (holding) company and subsidiary companies
- Corporate life cycle
 - Incorporation – Registration – Operation – Growth / Change of Structure – Winding up (either due to insolvency, or resolution of members) – Deregistration
- To be covered in Podcast 2 and Seminar 2

Internal management of companies

- Directors may be classified as:
 - Executive – Employment contract with company
 - Non-executive – No employment contract with company – only association through role as director
- Board of Directors – Chair of board
- Chief Executive Officer / Managing Director
- Company Secretary
- Larger companies and organisations: In-house / corporate counsel
- Constitution – Sets out rules for the governance of company – eg:
 - Issue and transfer of shares
 - Powers of directors
 - Authority of agents and corporate contracting
 - Meetings of directors and members (Covered in Podcast 4 and Seminar 4)
 - Changes to company structure and activities
- Has the effect of an enforceable contract between company and its members
- To be covered in Podcast 3 and Seminar 3

Corporate regulation in Australia

- Earlier examples of corporations (eg British East India Company) – incorporation by royal charter or specific legislation
- UK companies legislation from 1844 onwards; Australian colonial companies legislation
- Commonwealth Constitution s 51(xx) – “foreign corporations, and trading or financial corporations” - interpreted narrowly to apply to already-formed companies
- Responsibility for corporate legislation rested with States and territories – eg Uniform Companies Acts 1961
- Inadequacies and inconsistencies in regulation of companies and financial markets by State-based Corporate Affairs Commissions
- Examples of corporate and market collapses
- 1980s National Co-operative Scheme – Companies Codes; National Companies and Securities Commission
- 1990s Corporations Law Scheme; Australian Securities Commission
 - Further constitutional challenges over cross-vesting legislation
 - So – States and territories voluntarily agreed to transfer their corporate regulatory powers to Commonwealth – renewed every 5 years → Hence we now have the *Corporations Act 2001 (Cth)*
 - Australian Securities and Investments Commission (www.asic.gov.au) – www.moneysmart.gov.au
 - The regulator of Australian companies, financial markets, financial services – and more recently consumer credit and business names
 - Regulation – Registration and licensing; Policy guidance; Investigation and Enforcement functions
 - Maintains public registers of Australian companies and financial services providers
 - ASIC also responsible for consumer education on financial matters: www.moneysmart.gov.au

Themes in corporate law

- Corporate law – Involves both legislation (*Corporations Act 2001 (Cth)*) and common law
- Some themes examined in this subject:
- Protecting the rights of members and investors – disclosure of information; participation in meetings; approval of major decisions
- Ensuring directors act in company’s best interests → Conflicts of interest, good faith, proper purpose, duty of care and diligence
- Safeguarding rights of creditors
- Integrity of financial markets – timely and accurate disclosure; prohibition on insider trading
- Enforcement by ASIC and other regulators; members and creditors
- Remedies for breaches