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Week 1 – Nature and Incorporation of Companies

Overview

- Company law regulates the creation, structure, management, and dissolution of corporations in Australia.
- The Corporations Act 2001 (Cth) is the principal legislation, administered by ASIC (Australian Securities and Investments Commission).
- Company law ensures accountability, transparency, and protection for investors, creditors, and the public.
- The corporate form facilitates economic growth by separating ownership and management, limiting liability, and providing perpetual succession.

Key Features of a Company

- Separate legal entity – distinct from its members and directors.
- Limited liability – shareholders’ liability limited to unpaid amounts on shares.
- Perpetual succession – continues despite changes in membership.
- Transferable shares – ownership can be transferred easily.
- Centralised management – directors manage, shareholders own.
- Ability to sue and be sued in its own name.

Legal Personality

- Upon registration, a company becomes a separate legal person (Corporations Act s 119).
- A company can hold property, sue and be sued, and continue independently of its members.
- Members are not liable beyond their share capital unless they provide guarantees (s 516).

Key Case: *Salomon v A Salomon & Co Ltd* [1897] AC 22

Facts: Salomon formed a company and sold his boot business to it. He held most shares and was a secured creditor. When the company failed, liquidator argued the company was a sham. Held: The company was a distinct legal person. Salomon was not personally liable for its debts.

Principle: Upon registration, a company is a separate legal entity from its members, even if one person controls it.

Significance

- Foundation of modern corporate law.
- Shields shareholders from personal liability.
- Criticised for potential abuse (use of “corporate veil” to avoid obligations).

Lifting or Piercing the Corporate Veil

Courts may disregard the separate entity principle in limited circumstances:

- To prevent fraud or sham (*Gilford Motor Co Ltd v Horne* [1933] Ch 935).
- To avoid evasion of legal duties (*Jones v Lipman* [1962] 1 WLR 832).
- Where agency exists between company and controlling individual (*Smith, Stone & Knight Ltd v Birmingham Corporation* [1939] 4 All ER 116).
- Group enterprise doctrine – sometimes used where subsidiaries act as agents or alter egos.
- Statutory veil lifting occurs in cases like insolvent trading (Corporations Act s 588G) or when directors incur personal liability for company offences.

Advantages of Incorporation

- Limited liability encourages investment.
- Separate legal personality provides continuity.
- Transferability of shares allows liquidity.
- Access to external capital markets.
- Credibility and regulatory structure.

Disadvantages

- Formalities and regulatory compliance costs.
- Separation of ownership and control may cause agency problems.
- Limited liability can enable moral hazard (risk-shifting to creditors).

Registration Process

- Governed by Chapter 2A of the Corporations Act.
- Requirements under s 117:
 - Name of company.
 - Type of company (public or proprietary).
 - Registered office and principal place of business.
 - Share structure and details of members, directors, secretary.
- Upon registration, ASIC issues an Australian Company Number (ACN) and certificate of incorporation.
- Company comes into existence at the beginning of the day on which it is registered (s 118).

Types of Companies

1. Proprietary company (Pty Ltd):
 - Restricted to 50 non-employee shareholders (s 113).

- Cannot raise funds from public.
- Often family or small business structures.
- 2. Public company (Ltd):
 - May offer shares to public (subject to disclosure rules).
 - Must have at least 3 directors and 1 company secretary (s 201A).
 - Subject to stricter reporting and audit obligations.
- 3. Companies limited by guarantee (e.g. charities).
- 4. Unlimited companies (rare).
- 5. No liability companies (for mining ventures).

Company Constitution and Replaceable Rules

- Internal governance governed by:
 - A constitution adopted by members (s 136).
 - Replaceable rules under s 141 (default provisions).
- Replaceable rules cover matters like:
 - Director appointment/removal.
 - Meetings.
 - Dividends and share transfers.
- A proprietary company with a sole director/member may choose to operate without replaceable rules (s 135(1)).

Pre-registration Contracts

- Promoters may enter into contracts before incorporation.
- Common law: company could not ratify pre-incorporation contracts because it did not exist (*Kelner v Baxter* (1866) LR 2 CP 174).
- Statutory solution: Corporations Act s 131.
 - Person who enters into a contract on behalf of a company before registration is personally liable unless the company ratifies the contract within a reasonable time.
 - Court can order company or person to pay damages if contract not performed.

Promoters and Fiduciary Duties

- A promoter stands in a fiduciary relationship with the company being formed.
- Must disclose any profits, interests, or secret commissions.
- Breach may lead to rescission or account of profits (*Erlanger v New Sombrero Phosphate Co* (1878) 3 App Cas 1218).

Corporate Veil and Group Enterprises

- Group of companies are generally treated as separate entities.
- Courts reluctant to treat group as single entity unless agency or sham exists (*Adams v Cape Industries plc* [1990] Ch 433).
- However, statutory provisions can treat group as consolidated (e.g. taxation, insolvency).

Common Law and Statutory Interplay

- Corporate personality doctrine from *Salomon* supplemented by statutory obligations under Corporations Act.
- Directors' duties (ss 180–184) ensure accountability despite limited liability.
- Disclosure and reporting rules protect creditors and investors.

Exam Focus

- Identify when separate legal personality applies.