

## Class 1A: Introduction to Business Associations

### Sole Traders (PS) [1.20]

- Base line and most elemental form of business structure
- Its simplicity and ease of establishment and operation are its principal attractions
- Metaphor of the lemonade stand
- Main financial strength is also its main weakness. If the business succeeds all profits belong to the entrepreneur/trader. If the business fails then all liability and risk fall on that person
- Constraints to growth and capital accretion
- Business has intrinsic key person risk and succession planning problems
- Typically, a point of departure only – e.g., Aron Salomon was a successful sole trader!

### Partnership (PS) [1.30-60; 1.80-120; 1.130-150; 1.180-210]

#### Definition of Partnership

Persons carrying on a business in common with a view to profit (s1 of [NSW Partnership Act](#))

- **Conduct of a business:** connotes acts of repetition or continuity of business and not merely a one off transaction
- **By persons in common:** i.e. acting as principals together vis a vis 3<sup>rd</sup> parties but all as agents of one another
- **For profit:** sharing of profits (and implicitly losses) as opposed to any other output e.g., product as in product of a joint venture

#### Consequences of Partnership

- Partners are jointly and severally liable for debts and obligations which arise in the ordinary course of partnership business
- Vis a vis 3<sup>rd</sup> parties and the outside world partners are principals
- *Inter se* partners are agents of one another and owe each other fiduciary (and not merely contractual) duties

#### Indicia of Partnership

- Early cases (C19) try to characterise relationship as that of partnership or merely one of debtor/creditor
- Test is: **What is the real agreement between the parties?** So, **Courts favour a substance over form approach** in answering this question. Although the question looks facile the judges engage in a subtle weighing up of factors or indicia
- Parties' own characterisation of their relationship will not be conclusive and may be irrelevant and simply ignored (e.g. [Re Megevand](#); [Ex parte Delhasse](#) [1.70])
- In [Megevand](#), despite parties disavowing partnership James LJ declaimed : “ If ever there was a case of partnership, this is it .”

- Relevant indicia: 1. Loan was the only partnership capital; 2. Creditor had right to inspect debtor partnership's books; 3. Creditor had right to dissolve partnership if loan not repaid; and 4. Profit sharing arrangement between lender and debtor partnership
- Repayment of loan was contingent on success of business and apparently non-recourse to borrower!
- C19 cases are marginal and look somewhat odd by modern day standards

### **Partners as Fiduciaries**

- Partners owe fiduciary and not merely contractual duties to one another
- Note florid comments of Cardozo J in *Meinhard v Salmon*
- *Birtchnell v TEA* and *Chan v Zacharia* are 2 important HC cases describing the extensive parameters of Partners' fiduciary duties
- In *Birtchnell* the rogue Partner was participating in – and profiting from – a cognate business. Question for determination was whether those profits belonged to the Partnership
  - Test is: Were the contested profits earned within the scope of the Partnership business?
  - In *Birtchnell* the HC analysed the case in conflict of interest terms - a useful organising principle and also at the heart of Directors' fiduciary duties (Class #12)
  - Dixon J found a sufficient connection between what Porter was doing with Spreckley outside the Partnership and the primary RE Partnership to make Porter accountable for those ex-Partnership profits
  - Porter working "both sides of the street"
- In *Chan v Zacharia* the High Court held that fiduciary duties remained owing as between Partners notwithstanding the dissolution of the Partnership itself. In this case Dr Chan held the benefit of the renewal option of the practice premises leases on constructive trust for he and his former Partner Dr Zacharia
  - Justice Deane made clear that where a fiduciary (i.e. Dr Chan) holds a benefit (i.e. an option of renewal under an expiring lease) obtained by reason of his fiduciary position (i.e. as a Partner in the Chan/Zacharia Medical Practice) then that benefit is held on a constructive trust for the person to whom the fiduciary duty is owed (i.e. Dr Chan's Partner Dr Zacharia)

### **Joint Ventures**

- An association of persons typically for the purpose of delivering a specific project or transaction, as opposed to a continuing business – though distinction in the cases is quite loose
- Popular in mining and resources industries
- Can be both incorporated or unincorporated (we focus on latter in Class #1)
- Typically, joint venturers owe one another contractual but not fiduciary duties: Cf. *UDC v Brian*

**Differences between Partnership and Joint Venture**

- Frequently confused and conflated
- The distinction depicts the difference between profit (Partnership) and product (JV) and what is being shared by the participants
- High Court case of **Canny Gabriel v Volume Sales** is instructive
- Use of the term “joint venture” by the participants irrelevant and HC ignores it
- HC finds there to be a partnership between VS and 4<sup>th</sup> Media & Management based on the following indicia: 1. VS to share in profits (and Court assumes losses); 2. VS to participate in management of “joint venture”; 3. VS/4<sup>th</sup>M&M jointly involved in policy and management matters (Point 2 repeated); and 4. VS concerned with 4<sup>th</sup> M&M financial health (!!)
- HC finding despite there being no “partnership account “, i.e., no operating account to which the putative Partners had joint access for purposes of running the Partnership business. Box office proceeds paid into VS account which it controlled
- Where the venture failed 4<sup>th</sup> M&M had to repay the loan which suggests that VS was not interested in bearing losses
- **Decision is ambiguous and shows how outcome depends on weighing up the indicia of Partnership:** can analyse relationship between 4<sup>th</sup> M&M and VS as debtor/creditor, JV or Partnership. All are arguable

**Partnership Cases [1.60; 1.100; 1.190; 1.200]**

**Canny Gabriel Castle Jackson Advertising Pty Ltd v Volume Sales (Finance) Pty Ltd (1974) 131 CLR 321 [1.60] - Emphasises substance over form when evaluating whether a business structure is a partnership or something else; partnership may be formed without its parties being aware that they are in a partnership**

<p><b>Facts</b></p>	<ul style="list-style-type: none"> <li>• FMM was a music promoter that had contracts for the appearance of the singers Cilla Black and Elton John.</li> <li>• VS(F) agreed to finance the tours</li> <li>• The written agreement between the two entities assigned one half of the interests in the contracts on the basis of a joint venture</li> <li>• The finance advanced to the joint venture was described as a loan to the joint venture</li> </ul>
<p><b>Held</b></p>	<ul style="list-style-type: none"> <li>• Cl 1 of the contract, in consideration of the advance of \$70 000 and further sums, Fourth Media agreed to assign Sales “a one half interest in the above recited contracts and to perform the said contracts as a joint venture”.</li> <li>• <b>Our conclusion that the JV was a partnership</b>, from which the parties anticipated profits and provided that the advance by VS to the JV should be a first charge upon profits and that upon the repayment of such sum the profits should be divided equally, <b>rests upon the following considerations:</b> <ol style="list-style-type: none"> <li>1) The parties became joint venturers in a commercial enterprise with a view to profit</li> <li>2) Profits were shared: see <a href="#">Partnership Act (NSW) s 2(iii)</a></li> </ol> </li> </ul>

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	<p>3) The policy of the JV was a matter for joint agreement and it was provided that differences relating to the affairs of the JV Should be settled by arbitration</p> <p>4) An assignment of half interest in the contracts for the appearances of the singers was attempted, although, we would have though, unsuccessfully</p> <p>5) The parties were concerned with the financial stability of one another in a way which is common with partners</p> <ul style="list-style-type: none"><li>• The contract exhibited all the indicia of a partnership except that it did not describe the parties as partners and did not provide expressly for the sharing of losses, although we venture to think that it did so impliedly.</li></ul>
<b>Other</b>	<ul style="list-style-type: none"><li>• Explained by Neylan in class that whether a partnership was present was a preliminary issue in regard to priority of interests (that is why Fourth Media is not a party to the case – it's a creditor/debtor priority thing)</li><li>• Though Neylan disagreed with the outcome in the case (he articulated that it should have likely been a creditor/debtor relationship), HC said it was a partnership</li><li>• The HC paid <b>specific attention to the fact that there was a mutual view to profit</b> from both sides</li><li>• The <b>HC conceded that there was no intended repetition</b> in this case and that this was clearly intended to be a one-time affair by both parties</li></ul>

### [Duke Group Ltd \(in liq\) v Pilmer \[1.100\]](#)

- Courts have adopted different interpretations regarding the meaning of “in common”.
- **The first approach is discussed in Duke Group and holds that the “in common” element implies two requirements:**
  1. The existence of an agency relationship between the partners regarding the conduct of the business. (This means that individual partners can incur an obligation for which all the other partners are also responsible).
  2. Existence of mutual rights and obligations inherent in a partnership relationship
- The second approach taken by the courts is reflected in a line of HC decisions which focus only on the existence of the second requirement detailed above.
  - While this requires only that the parties have accepted some level of mutual rights and obligations in the partnership, “there is no one provision or feature which can be said to be absolutely necessary to the existence of a partnership, so that the absence of that feature inevitably negates the existence of a partnership or joint venture”.

### [Birchnell v Equity Trustees, Executors; Chan v Zacharia \[1.190-200\]](#)

- These two cases deal with the distinctive partnership feature of **mutual trust and confidence**
- Like directors and officers in a company, **partners should avoid conflicts of interests**. They cannot make secret profits, nor can they compete with the firm except if they get the other partners' approval. The fiduciary duty extends to the process of dissolution of a partnership and may even arise after the dissolution of a partnership but before the winding up of the affairs of the partnership.

**Partnership Act [1.120]**

- For the most part not conclusive but take their place along with other indicia which provide a guide to the existence or not of partnership arrangement.
- The establishment of a joint tenancy, tenancy in common, joint property or joint ownership does not by themselves result in a presumption of the existence of a partnership. (s 2(1)(1) Partnership Act 1892 (NSW))
- The sharing of net profits usually creates a presumption of partnership. (s 2(1)(3) Partnership Act 1892 (NSW))
- Sharing of “gross returns” does not of itself create a partnership, whether or not there is a joint or common interest in any property from which, or from the use of which, the returns are derived. (s 2(1)(2) Partnership Act 1892 (NSW))
- Number of specific instances listed where receipt of a share of profits does not of itself make the recipient a partner. (s 2(3) Partnership Act 1892 (NSW))

**JV Case [1.250]**

**United Dominions Corporation Ltd v Brian Pty Ltd**

- Outlines the broad definition of the term “joint venture” and some of the difficulties in determining whether a relationship is a JV

**Unincorporated BA table**

Type	Description				
Sole trader	<ul style="list-style-type: none"> <li>• <b>Sole trader:</b> runs business in their own name as a natural person (maybe 1 or 2 employees)</li> <li>• The identity of the sole trader in control of the business are merged</li> <li>• The sole trader gets to keep all the profit but also bears all of the liability – if the business goes bust they may lose everything they own</li> </ul> <table border="1" data-bbox="357 1335 1506 1787"> <thead> <tr> <th data-bbox="357 1335 935 1375">Benefits</th> <th data-bbox="935 1335 1506 1375">Drawbacks</th> </tr> </thead> <tbody> <tr> <td data-bbox="357 1375 935 1787"> <ul style="list-style-type: none"> <li>• Flexible</li> <li>• Easily set up (person can set up newspaper stand that says “NEWSPAPERS SOLD HERE”)</li> <li>• Owner is in control</li> <li>• Allows owner to keep all profit</li> </ul> </td> <td data-bbox="935 1375 1506 1787"> <ul style="list-style-type: none"> <li>• Unlimited liability: sole trader is liable for all debts and liabilities of the business</li> <li>• Life of the business linked to life of sole trader</li> <li>• Limited opportunities for tax minimisation –all income received by the business is taxable on a personal income basis</li> <li>• Sole trader cannot raise capital on the market</li> </ul> </td> </tr> </tbody> </table> <p data-bbox="357 1823 1506 1960"><b>NOTE CORPORATIONS OFTEN PREFERABLE TO BEING A SOLE TRADER:</b> limited liability and taxation considerations sometimes prompt sole traders to conduct their business through a corporation of which they may be sole shareholder and director</p>	Benefits	Drawbacks	<ul style="list-style-type: none"> <li>• Flexible</li> <li>• Easily set up (person can set up newspaper stand that says “NEWSPAPERS SOLD HERE”)</li> <li>• Owner is in control</li> <li>• Allows owner to keep all profit</li> </ul>	<ul style="list-style-type: none"> <li>• Unlimited liability: sole trader is liable for all debts and liabilities of the business</li> <li>• Life of the business linked to life of sole trader</li> <li>• Limited opportunities for tax minimisation –all income received by the business is taxable on a personal income basis</li> <li>• Sole trader cannot raise capital on the market</li> </ul>
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Partnership (General partnerships & Limited Partnerships)	<p>1. <b>General partnership:</b> two or more people working together in common (needs to be &gt;2 people. Usually there is a limit of 20 people except in certain professions which allow more)</p>												
	<p>If a court is considering if a <b>business is a partnership</b>, it will consider <b>3 requirements:</b></p>												
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	<p><b>CHARACTERISTICS OF A PARTNERSHIP</b></p> <ul style="list-style-type: none"> <li>• <b>Not a separate legal entity:</b> similarly to a sole proprietorship, the identity of the business is intertwined with the partners (usually if a partner dies the partnership is dissolved)</li> <li>• <b>Personal liability:</b> there is personal liability (the partner may risk everything that they own if the partnership is not successful)</li> </ul> <p>2. <b>Limited partnership:</b> in a general partnership there are the general partners (that have personal liability) and the limited partners (that have limited liability)</p> <ul style="list-style-type: none"> <li>• Limited partnerships require registration as a condition of the limited liability</li> <li>• The Limited Partnership must identify itself with “LP” in its name</li> </ul>												
Joint Venture ('JV')	<p><b>JV:</b> agreements by contract to engage in an ad hoc profit project by combining resources, but without binding the other venturers. Examples include exploration for minerals and exploitation of new technologies.</p> <p>However, there are key differences to a partnership:</p>												

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	<ul style="list-style-type: none"> <li>• <b>No requirement for the venture to be “in common”</b> <ul style="list-style-type: none"> <li>○ JV does not require agency relationship or fiduciary duty</li> </ul> </li> <li>• <b>JVs share a “product”</b> where as a partnership shares “profit” (not the profit that comes from a product but the product itself)</li> <li>• <b>The liability in a JV is individual rather than joint</b> and several as in a partnership</li> <li>• Subject to agreement, the <b>joint venturers are free to dispose of their interest in the JV</b>. This is not the case in a partnership as the change of partners may result in the dissolution of the partnership</li> </ul>								
<p>Unincorporated Non-Profit Association</p> <p>These are basically just clubs</p>	<p><b>Unincorporated Association:</b> a group of people who agree to act together as an organisation and form an association</p> <ul style="list-style-type: none"> <li>• Group can remain informal &amp; its members make own rules on how the group is managed</li> <li>• Not a separate legal entity and can only be used for not-for-profit activities</li> </ul> <table border="1" style="width: 100%; border-collapse: collapse; margin-top: 10px;"> <tr> <th colspan="2" style="text-align: center; color: blue;">Wise v Perpetual Trustee Co Ltd (Privy Council)</th> </tr> <tr> <td colspan="2" style="padding: 5px;"> <p>“...clubs are associations of a peculiar nature. They are societies <b>the members of which are perpetually changing</b>. They are <b>not partnerships</b>; they are not associations for gain; and the feature which distinguishes them from other societies is that <b>no member as such becomes liable to pay to the funds of the society</b> or anyone else any money beyond the subscriptions required by the rules of the club to be paid so long as he remains a member.”</p> </td> </tr> <tr> <th style="width: 50%; text-align: left; color: green;">Benefits</th> <th style="width: 50%; text-align: left; color: red;">Drawbacks</th> </tr> <tr> <td style="vertical-align: top; padding: 5px;"> <ul style="list-style-type: none"> <li>• Easy to set up</li> </ul> </td> <td style="vertical-align: top; padding: 5px;"> <ul style="list-style-type: none"> <li>• Not a separate legal entity</li> <li>• May be a problem with donations – gifts cannot be held in the name of an unincorporated association because these associations have no separate legal existence</li> <li>• May be problems with validity of long term contract</li> <li>• Committee is liable for debt of the association</li> </ul> </td> </tr> </table> <p style="margin-top: 10px;"><b>NOTE:</b> committee members risk being personally liable for the debt of the corporation. When liability starts rising we convert entity to incorporated association</p>	Wise v Perpetual Trustee Co Ltd (Privy Council)		<p>“...clubs are associations of a peculiar nature. They are societies <b>the members of which are perpetually changing</b>. They are <b>not partnerships</b>; they are not associations for gain; and the feature which distinguishes them from other societies is that <b>no member as such becomes liable to pay to the funds of the society</b> or anyone else any money beyond the subscriptions required by the rules of the club to be paid so long as he remains a member.”</p>		Benefits	Drawbacks	<ul style="list-style-type: none"> <li>• Easy to set up</li> </ul>	<ul style="list-style-type: none"> <li>• Not a separate legal entity</li> <li>• May be a problem with donations – gifts cannot be held in the name of an unincorporated association because these associations have no separate legal existence</li> <li>• May be problems with validity of long term contract</li> <li>• Committee is liable for debt of the association</li> </ul>
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**NOTE:** for JV or Partnership, business relationship can be forged by any 2 legal entities (e.g. people or corps)

Incorporated BA table

Type	Description
<p>Cooperative</p> <p><b>NOTE:</b> can be for profit or not-for-profit</p>	<p><b>Cooperative:</b> group of people who pool resources together to achieve a common goal</p> <p>The features of a cooperative are:</p> <ul style="list-style-type: none"> <li>• Separate legal entity (limited liability)</li> <li>• Open membership</li> <li>• One vote per member</li> <li>• Commitment to educating members &amp; employees with cooperative principles</li> <li>• Concerns for communities</li> </ul>
<p>Incorporated Association (Not for profit)</p> <p><b>NOTE:</b> regulated by state legislation</p>	<p><b>Incorporated Association:</b> can only be used for not-for-profit activities</p> <ul style="list-style-type: none"> <li>• <b>Separate legal entity:</b> since the incorporated association is a separate legal entity, it has all the powers of an individual</li> <li>• Generally managed by a committee - powers &amp; duties in the association's rules</li> <li>• As a separate legal entity, it can receive gifts and own property</li> <li>• It will be liable for any contract entered into on its behalf</li> <li>• The committee &amp; the members of an incorporated association are not liable to contribute towards payment of liabilities of the incorporated association</li> </ul>
<p>Aboriginal and Torres Strait Islander Corporations</p>	<ul style="list-style-type: none"> <li>• subject to CATSI Act, similar regulatory scheme to CA but adapted to recognise cultural differences, administered by Registrar of Indigenous Corporations (ORIC)</li> </ul>

**Class 1B: Company Types & Creation**

**Why Incorporate? [4.100-50]**

Various factors affect the decision whether to incorporate or whether to remain an unincorporated business association. For a large enterprise the advantage of incorporation is likely to compel registration under the **Corporations Act** however the case will not be clear-cut for smaller enterprises.

- A company is an **artificial legal person** with a real existence
- A company exists solely in the contemplation of the law
- Principal features of a company:
  - a) indefinite succession;
  - b) Can own its own assets (and bear its own liabilities!);
  - c) Can sue (and be sued) in its own name;
  - d) Separate legal and commercial entity status
- Shareholders
  - Reap financial gains (dividend yield and capital gains)
  - Do not need to participate (cannot actually manage the company)

Advantages	Disadvantages
<ul style="list-style-type: none"> <li>• Limited liability                             <ul style="list-style-type: none"> <li>○ Incorporation provides members/shareholders with limited liability</li> </ul> </li> <li>• Perpetual succession                             <ul style="list-style-type: none"> <li>○ A company is an entity distinct from the individuals comprising its members</li> <li>○ It can therefore continue to exist even after the death, bankruptcy or so forth of its members such that it can continue to exist, unlike for instance, partnerships.</li> </ul> </li> <li>• Financing                             <ul style="list-style-type: none"> <li>○ Companies have greater access to finance, such as the ability to create a floating charge or raise capital through public issue of shares.</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• Cost, formality and continuing obligations                             <ul style="list-style-type: none"> <li>○ Cost, formalities and obligations imposed on incorporated associations far outweighs those on unincorporated associations</li> <li>○ Partnerships are flexible in terms of creation, internal structure, withdrawal of capital and dissolving the entity</li> <li>○ In contrast the procedure of incorporation involves formalities as does the process of winding up a company</li> <li>○ In addition companies must comply with an array of ongoing obligations and failure to do so attracts penalty</li> </ul> </li> <li>• Taxation                             <ul style="list-style-type: none"> <li>○ Historically there was a double taxation consequence attached to incorporated however this is no longer an issue due to the dividend imputation provisions introduced in the 1980s which eliminates the double taxation of company dividends.</li> </ul> </li> </ul>