

LAWS1091 – BUSINESS ASSOCIATIONS MIDTERM

SEPARATE LEGAL ENTITY; LIFTING THE CORPORATE VEIL

<p>Separate Legal Entity</p>	<ul style="list-style-type: none"> - Once Registered, the Co. instantly is invested w/ legal capacity and the powers of the individual (s 124; Salomon). This includes: <ul style="list-style-type: none"> - Can commit crime and tort + receive injury for defamation but not feelings (<i>Lewis v Daily Telegraph; Mirror Newspapers</i>). - Relies on a representative in Court - Cannot invoke the CL privilege against self-incrimination (<i>EPA v Caltex</i>) - Not included under residents s 75(iv) Constitution (<i>Australasian Temperance & General life Assurance Society v Howe</i>) → this term is restricted to flesh and blood - Cannot be considered a subject of the Queen s 117 Constitution – Corps are not capable of personal allegiance (<i>Motel Marine v IAC</i>) - Co may be an enemy alien determined by the nat of the persons in control (<i>Daimler</i>) - Does not matter if its 1 person co, still SLE (<i>Lee Air Farming; Saloman</i>) → The Co and L were 2 separate & distinct legal persons – unaffected by L's position being a governing director and agent (<i>Lee</i>) - Perpetual Succession = no temporal limits - Company is at law a different person altogether from the subscribers to the memorandum (<i>Salomon s Case</i>) <ul style="list-style-type: none"> - Establishes the complete legal separation of a company and its members - Establishes the separate legal entity principle - The principle is reinforced and effect by ss 119 and 124 <ul style="list-style-type: none"> ▪ While a company registered under Corporations Act is invested with the legal capacity & powers of an individual (s 124) its incorporeal nature ensures that it enjoys perpetual succession. ▪ While a company may commit crime & tort → its rights and obligations are NOT identical to that of an individual e.g. injury 	<p>Salomon v Salomon</p> <p>Key principle: <i>a company, once incorporated, is a separate legal entity from its members and its debts and obligations are its own, not those of its shareholders</i></p> <ul style="list-style-type: none"> - The corporate veil will not be lifted merely because one shareholder has dominant control over the company <p>PIERCING THE VEIL</p> <ul style="list-style-type: none"> - Principle of separate legal entity (s 124; Salomon) → grounds for lifting the veil - <i>Briggs v James Hardie & Co Ltd</i> <ul style="list-style-type: none"> - The threshold problem arises from the fact that there is no common, unifying principle, which underlies the occasional decision of courts to pierce the corporate veil. Although an ad hoc explanation may be offered by a court which so decides, there is no principled approach to be derived from the authorities - <i>Dennis Wilcox Pty Ltd v Federal Commissioner of Taxation</i> <ul style="list-style-type: none"> - The separate legal personality of a company is to be disregarded only if the court can there is, in fact or in law <ul style="list-style-type: none"> ▪ A partnership between companies in a group, or ▪ That there is a mere sham or facade in which that company is playing a role, or ▪ That the creation or use of the company was designed to enable a legal or fiduciary obligation to be evaded or a fraud to be perpetrated <p>A case may be assigned to more than one category – the categories are examined sequentially</p>
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	<p>to the the corporate reputation may be mitigated by an action for defamation - although the company may recover only for injury to the pocket & NOT its feelings</p> <ul style="list-style-type: none"> ▪ While the company may be in contempt of court → it is incapable of personal appearance AND must appear through a representative 	
<p>Lifting the Corporate Veil</p>	<p>1. Apply Salomon</p> <p>2. Fraud</p> <ul style="list-style-type: none"> a. If the company was acting incorporated to act as a device of fraud, then the court may pierce the veil to hold the director liable b. To argue this, it is required that the controller have used the company to evade a legal or fiduciary obligation that would otherwise fall on that controller specifically <p>3. Sole, or dominant purpose of enabling another person to avoid an existing legal obligation</p> <ul style="list-style-type: none"> a. <p>4. Under resourced company's may be agents of their controllers or to be shams or devices (<i>Smith Stone & Knight Ltd v Birmingham Co</i>)</p> <ul style="list-style-type: none"> a. <i>Were the profits treated as the profits of the parent Co?</i> b. <i>Were the persons conducting the business appointed by the parent Co?</i> c. <i>Was the Co the head and the brain of the trading venture?</i> d. <i>Did the Co govern the adventure decide what should be done and what capital should be embarked?</i> e. <i>Did the Co make profits by its skill and direction?</i> f. <i>Was the Co effectual and constant control?</i> <ul style="list-style-type: none"> i. → ALL 6 must be answered with YES [NOTE!!!!] AUST Courts are divided on the 6 element test – not all Aust Courts are happy – ii. Bird Cameron: elements 2 – 6 are all about control – (The exercise in fact of some control over the subsidiary is insufficient Hardie) → <i>Smith Stone & Knight</i> – the facts were essential = you MUST find similar facts + all 6 steps (i.e., 1 	<p>The issue is whether the corporate veil (<i>Salomon</i>) can be lifted due to [FRAUD/IMPROPER CONDUCT] on behalf of [DEFENDANT] (<i>Gilford Motor</i>)</p> <p>AND</p> <p>Here, [DEFENDANT'S] conduct constituted fraud because (<i>apply facts</i>)</p> <p>AND</p> <p><u>Avoiding legal or equitable obligations</u></p> <ul style="list-style-type: none"> - As analogous to <i>Gilford Motor</i>, [DEFENDANT] set up [COMPANY] to breach or avoid equitable or legal obligations, those being _____ [non-solicitation clause?] <p>OR</p> <p>As analogous to <i>Gilford Motor</i>, [DEFENDANT] set up [COMPANY] to poach clients from his former employer. This was fraudulent because it allowed [DEFENDANT] to circumvent a _____ [<i>restraint, non-compete, non-solicitation</i>] clause in an employment contract</p> <p>OR</p> <p><u>Transferring land</u></p> <p>As analogous to <i>Jones v Lipman</i>, [DEFENDANT] transferred land to a newly acquired company at significantly less sum to prevent an action for specific performance</p> <p>OR</p>

- manager, no employees w/ everything else derived from the parent) → the company could not function in its own right.
- iii. Essentially the subsidiary will have to be a shelf company

5. Insolvency

- a. Directors personally liable when co. take on debts when they are already insolvent, or when the debt will make the company insolvent
- b. Limited liability of shareholders persists, but creditors have some rights against company controllers who act in this way

Re-Darby; Ex Parte Brougham → COMPANY USED TO DE FRAUD INVESTORS/CREDITORS

- **A company will not be treated as a separate legal entity if it is merely a facade used to commit fraud on investors or creditors**

- **FACTS:** Two individuals formed a corporation and used it to promote another company. CoLIC issued debentures to investors, falsely representing that their funds would be secured but they had no genuine business operations. In reality CoLIC was a front for the fraudsters who **misappropriated funds** by diverging them for personal use.
- **HELD:** Sham company and not a separate legal entity

Guildford Motor Co Ltd v Horne → LOOK FOR PRE-EXISTING LEGAL DUTY AND THEN INCORPORATION OF A COMPANY

- **Corporate veil can be lifted where a company is a sham used to evade pre-existing legal obligations**

- **FACTS:** Horne was a managing director at Gilford Motor Co and had a contractual non-solicitation clause preventing him from poaching customers after leaving. After registering, he began a competition business, selling parts and servicing Gilford vehicles. Shortly after requesting a copy of his contract, his wife incorporated JM Horne & Co which took over his business
- **HELD:** **Company was a sham to disguise Horne's breach.** Veil was lifted and an injunction was granted against both Horne and the company to prevent further solicitation.

Defrauding investors

As analogous to *Re Darby; Ex Parte Brougham* bankrupt individuals promoted a company which derived secret profits on the sale of grossly overvalued assets to another company which it had promoted
AND

[COMPANY] had no genuine business operations, and its _____ [*issuing debentures, or whoever else it defrauds investors*] was merely a front, diverting _____ [PERSON'S] funds for personal use.

AND/OR

Exception

Nonetheless, it could be argued that [DEFENDANT'S] conduct was insufficient to establish fraud because:

- The purpose for which [SUBSCRIBERS/SHAREHOLDERS] incorporated [COMPANY] were "lawful", since _____ (*Salomon*)
- The fact that _____ [*Mr Salomon personally lent \$5000 for the company on debentures that belonged to him*] is strong evidence of his good faith and of his confidence in the company (*Salomon*)

OR

- Although [DEFENDANT] is a predominant partner possessing an overwhelming influence in the company AND is entitled to practically all of the profits of [COMPANY], this does not automatically reduce the company to a 'sham' nor does it remove limited liability (*Salomon*)

OR

- Although [COMPANY] was used to conceal [ASSETS], there is a high threshold for piercing the corporate veil, and the court will only do this in exceptional circumstances. _____ [SITUATION] does not meet that threshold as _____ does not abuse the process of incorporation even though it _____ [hold assets on trust for its owner]. Thus, [COMPANY's] separate legal personality will be

	<p><i>Jones v Lipman</i> → LOOK FOR IF A PARTY TRANSFERS PROPERLY INTO A COMPANY SOLELY TO ESCAPE A CONTRACT</p> <ul style="list-style-type: none"> - Corporate veil was lifted where a company is a mere façade or sham to evade pre-existing legal obligations - FACTS: Lipman agreed to sell land for 5.5k but later changed his mind. Transferred the land to Alamed Ltd (company he personally controlled). - HELD: Sham company created to defeat the plaintiff’s right to specific performance. Lipman had control over Alamed and the company’s only purpose was to prevent the plaintiffs from enforcing the contract. <p>NOTE:</p> <ul style="list-style-type: none"> - Compare to <i>Gilford Motor Co Ltd</i> (company used to avoid contractual restrictions) - <i>Prest v Petrodel Resources</i> (company veil only lifted where it is used to evade obligations, not just conceal ownership) 	<p>upheld and [DEFENDANT] will not be held personally liable for _____. (<i>Prest v Petrodel</i>)</p>
<p>Subsidiary Definition</p>	<ul style="list-style-type: none"> - A subsidiary is a company that is controlled by another company, called a parent company or holding company - A company becomes a subsidiary IF the parent company <ul style="list-style-type: none"> - Owns more than 50% of the shares (majority ownership) ✓ - Has the power to control its board of directors, even without majority ownership ✓ - E.g. <ul style="list-style-type: none"> - Company A owns 80% of the shares in Company B - Company B is now a subsidiary of Company A - Company A is the parent company (or “holding company”) - Even though Company A owns most of Company B → COMPANY B IS STILL A SEPARATE LEGAL ENTITY 	
<p>Agency to ‘Pierce Corporate Veil’</p>	<ul style="list-style-type: none"> - Total control does not give rise to agency: <i>ACN 007 528 207 Pty Ltd (in liq) v Bird Cameron (Reg)</i> <ul style="list-style-type: none"> - Company acts as an agent or partner of controller but just because a holding company controls a subsidiary does not make the subsidiary an agent of the holding company - However in tort (see below) the holding company can potentially be held responsible for the tortious acts of a subsidiary <p><i>Smith, Stone & Knight Ltd v Birmingham Corp</i> →</p>	<p>NOTE: [PRINCIPAL] → the parent company// [SUBSIDIARY] → the smaller company</p> <ul style="list-style-type: none"> - Trying to hold [PARENT] liable rather than for actions for [SUBSIDIARY] <p>On the facts, agency (using the subsidiary as an agent of the parent company) ____ (can/cannot) be established because ____ (apply):</p> <ul style="list-style-type: none"> - [PRINCIPAL] was in effectual and constant control of [SUBSIDIARY] as evidenced by the fact that it ____ (<i>apply facts</i>)

- **A subsidiary may be deemed an agency of its parent company, allowing the parent to claim or assume liability for the subsidiary's actions.**

- **This challenges the separate legal personality principle from Salomon v Salomon and is controversial, especially in Australia**

- **FACTS:** Smith, Stone & Knight (SSK) was a paper manufacturer that owned a factory in Birmingham. It leased the factory to a wholly owned subsidiary (Birmingham Waste Co) which operated a waste paper business from the premises. The municipal authority sought to acquire the factory for the construction of technical college and issued a notice of treat (legal requirement in compulsory acquisition). SSK initially made the claim for compensation on behalf of its subsidiary but later amended it, arguing that the loss was suffered by SSK itself, not the subsidiary. The authority denied SSK's claim, arguing that compensation should be payable only to the occupier (the subsidiary), which was not entitled to compensation under the law because its tenancy exceeded on year
- **HELD: Subsidiary wasn't truly independent** – it was merely an agent of SSK. The **corporate veil wasn't pierced** but the court disregarded the SLP of the subsidiary to allow the claim. Consideration of **six questions** (ABOVE)

AND/OR

- The profits of [SUBSIDIARY] were treated as the profits of [PRINCIPAL], which is indicated by the fact that _____

AND

- [SUBSIDIARY] did not keep any books and its profits were credited to [PRINCIPAL], the principal (*Smith, Stone & Knight*)
- [SUBSIDIARY] never declared or thought to declare dividends (*Smith, Stone & Knight*)

AND

Furthermore, the persons who conducted the [SUBSIDIARY], those being [DIRECTOR's names] were appointed by [PRINCIPAL] AND Furthermore, [PRINCIPAL] was the head and brain of [SUBSIDIARY], as evidenced by the fact that it was behind the design of the business and made strategic decisions of [SUBSIDIARY] (*Smith, Stone & Knight*)

- [PRINCIPAL] did not formally assign business to [SUBSIDIARY]; rather [SUBSIDIARY] just carried them on (*Smith, Stone & Knight*)

AND

There was no tenancy agreement or rent paid by [SUBSIDIARY] to [PRINCIPAL] (*Smith, Stone & Knight*) AND [PRINCIPAL] made the profits by the skill and direction of [SUBSIDIARY] (*Smith, Stone & Knight*)