

LAWS2014 – Finals

Corporations Law

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Lecture 2: Capital Structure/Corporate Fundraising

- Debt vs Equity
 - Sources of funding
 - Characteristics of Equity
 - Characteristics of Debt
 - Choosing between the two
- Regulated fundraising under Chapter 6D
 - Is the company a public or private company?
 - Is there a 'offer' or 'invitation' for a 'security'?
 - If there is a security, it must have a disclosure agreement
 - Failure to comply is a civil penalty provision
 - Is there an exemption to disclosure?
 - Has there been a disclosure?
 - Does the disclosure comply with chapter 6?
 - Consequences of failure to lodge
 - Defective Disclosures
 - Deceptive and Misleading
 - Omission
 - New Circumstances
 - Defences
- Misleading or deceptive conduct
- Restrictions on advertising
- ASIC Stop Orders

1. Debt vs Equity

1) Sources of funding

a. S198A – Powers of directors – Corporations Act 2001

- i. (1) The business of a company is to be managed by or under the direction of the directors
- ii. (2) the directors may exercise all the powers of the company except any powers...
- iii. THIS includes deciding on money

b. The funding decision is usually deciding between the appropriate ratio of debt to equity for a company

c. Powers to issue shares and debt – *s124 Corporations Act*

2) Characteristics of Equity (i.e. Shares)

a. Company's power

- i. *S124 Corporations Act* -> Company has power to issue shares
- ii. *S254A Corporations Act* -> Companies can issue preference, bonus, partly paid or redeemable preference shares
- iii. *S254B Corporations Act* -> Company may determine the terms on which its shares are issued, and the rights and restrictions attaching to the shares

b. Definition of Shares

- i. A claim against the company to which the rights set out in the *Corporations Act* and the company's constitution attach
- ii. Nature of shares under the *Corporations Act s1070A*:
 1. A share, other interest of a member in a company or interest of a person in a registered scheme
 - a. Is personal property; and
 - b. Is transferable or transmissible as provided by:
 - i. The company's, or scheme's, constitution; or
 - ii. Operating rules of a prescribed CS facility if they are applicable; and
 - iii. Is capable of devolution by will or by operation of law
- iii. You have contractual rights, and statutory rights, against the company as a separate legal entity

c. Features

- i. Equity is only paid if company has sufficient assets and profits to pay dividends *s245T Corporations Act*
 1. *DSHE Holdings Pty Ltd* – directors should not rely on industry practice to demonstrate that they have exercised due care and diligence in distributing shares (i.e. don't do it when the company can't pay its creditors)
- ii. Dividend payments are discretionary payments

d. Rights of shares

- i. Right to vote at member's meeting
- ii. Rights to vote on company resolutions
- iii. Rights to receive information
- iv. Right to receive a dividend -> discretionary decision of the company to pay a dividend *s254U*
- v. Right to use members' remedies

e. Types of shares

- i. Ordinary shares
 1. One vote per share; ordinary dividend right
- ii. Preference shares
 1. Can have more or less voting or dividend rights than ordinary shares
 2. E.g. no voting right, but right to receive more dividends
 - a. Preference shares may also convert into ordinary shares or be bought back by the company (Redeemable preference shares)
 3. *Beck v Weinstock* – definition of preference shares is by reference to the rights set out in company's constitution, and not the company's ordinary shares

iii. Hybrid and convertibles

1. Can be convertible preference shares
2. Companies may issue hybrid investment instruments that have characteristics of both debt and equity, these may or may not carry voting rights
3. Convertible note: a loan by a company that entitles the lender to convert the loan (contractual debtor-creditor relationship) into a share (a membership chose in action)

iv. Options (put and call)

1. A company may issue options over shares to be issued in the future

3) Characteristics of Debt (i.e. Bonds/Debentures)

a. Features of debt

- i. Company required to pay interest at an agreed rate and repay principal at the end of agreed term
- ii. Lender has priority over shareholders for repayment of principal on winding up and is not a member of the company and has no membership rights
- iii. Capital provided is for a short or finite term, the expectation here is that it will be paid before the company is wound up

b. Types of debt

i. Loans and secured finance

1. Bank loans (can be secured or unsecured)
2. Secured debt is that the borrower pledges a specific asset or property which the lender can seize in the case of default
3. Fixed vs Circulating Security
 - a. Fixed is like a mortgage or charge over land, circulating is usually assets (e.g, trading stock) that a company is usually able to use, dispose, and deal within the ordinary course of business

ii. Debentures

1. Issuing bonds allows the investment to be traded (in a similar manner to trading shares) and be bought and sold in the secondary market
2. Under common law it is: 'any document which is evidence of debt' *Edmonds v Blaina*
3. *Corporations Act s9*: a chose in action that includes an undertaking by the body to repay as a debt money deposited with or lent to the body – chose in action may include a charge over property of the body to secure repayment of the money
4. Rights of Debenture Holders
 - a. Bond holders don't get to vote at company meetings (unless in liquidation or voluntary administration)
 - b. Bonds provide regular payments (as interest on the loan)
 - c. Convertible into equity (shares) -> benefit of holding shares over debt is that it has no expiration date

4) Choosing between the two

- a. Debt – interest paid on loans is potentially tax deductible under the Income Tax Assessment Act 1997
 - i. Does not extend membership rights to the lender
 - ii. No choice whether to make repayments (i.e. interest and principal must be paid)
- b. Equity – dividends are not tax deductible
 - i. No requirement to pay a dividend

2. Regulated fundraising under Chapter 6D

Chapter 6D requires disclosure whenever a company makes an offer of securities for issue s706, unless the offer falls within one of the exempted categories

1) Is it a public (ltd) or private company (pty ltd)?

- a. Public: companies are subject to chapter 6 disclosures
- b. Private: company may issue securities through activities that are exempt from chapter 6 disclosures CA 113(3)

2) Is there an offer for securities for issue?

- a. [a] Is there an offer or invitation?
 - i. Prima facie, if there is an offer for securities, there must be a corresponding disclosure statement s706 which is provided with the offer s721 unless an exemption applies
 1. An offer for securities is defined in s9 as
 - a. an invitation for applicants for the issue of the security and s9(a)(i)
 - b. invitation of offers to purchase the security s9(a)(ii)
 2. It includes distributing material to encourage a person to enter into a course of negotiations calculated to result in the issue of securities AG v Aus Fixed Trust.
 3. Chapter 6D does not apply to crowd sourced funding s703B
- b. [b] Is it a security? s92(5) and s700
 - i. Securities are defined in s92(5) for the purposes of chapter 6D s700, which include
 1. shares s92(5)(a)
 2. debentures s92(5)(b)
 3. legal or equitable right or interest in shares or debentures s92(5)(c)
 4. an option to acquire, by way of issue, a security covered of the above s92(5)(d)
 - ii. Chapter 6D does not recognise the following as securities per s700
 1. a right (whether existing or future and whether contingent or not) to acquire, by way of issue, the following under a rights issue: s92(5)(e) excluded through s700(1)(a)
 - a. a security covered by paragraph (a), (b), (c) or (d);
 - b. a managed investment product;
 - c. a foreign passport fund product.

- d. an interest or right covered by paragraph 764A(ba); or
 - 2. a CGS depository interest; or s92(5)(f) excluded through s700(1)(a)
 - 3. a simple corporate bonds depository interest; s92(5)(e) excluded through s700(1)(b)
- iii. If it is a stock, bond, or debenture issued by the government then it is not a security for the purpose of this chapter s92(3)
- 3) If there is a security on offer, then there must be a disclosure document issued in the content of Ch 6D
- 4) Failure to comply is a civil penalty s727

Exemptions from disclosure s708

Prima facie, [person] must lodge a disclosure document with ASIC s718 as there is an offer for securities s706 and it must be determined if [person] has satisfied the disclosure requirements

However, there are exceptions in s708 which have the effect of not requiring a disclosure document to be lodged. Further, the company bears the onus of proving that their offer falls within s708; Cyclone

1) Is it a small-scale offering?

- a. Small scale offerings are exempt from the disclosure requirements set out in chapter 6 if they satisfy certain criteria s708(1)
- b. [a] It must be a personal offer s708(2)
 - i. Must only be able to be accepted to whom the offer is made. s708(2)(a) or
 - ii. A offer to a person who is likely to be interested s708(2)(b) considering
 - 1. Previous contact between offeror and offeree,
 - 2. some professional or other connection between the offeror and offeree
 - 3. Statements or actions that indicate they are interested
- c. [b] In the past 12 months there must not be s708(3)-(7)
 - i. More than 20 issues; and
 - ii. Total funds raised more than \$2 million.
 - 1. The total amount calculated is to be determined by s708(7)
 - a. The amount paid at issuance;
 - b. Future payments due, for part paid shares if call is made
 - c. Amounts payable if options are exercised
 - d. Amounts payable, if convertible securities are exercised
 - iii. You should exclude s708(5)
 - 1. Raises that do not need a disclosure statement;
 - 2. Are not received in Australia
 - 3. Are made under a disclosure document

- d. NOTE - Offers to 20+ people but only 20 agreed: According to the decision in *ASIC v Cyclone Magnetic*, it is not the intention of *s708 CA* to be retrospectively relieved of a liability which they have already discharged by, for example, demonstrating that 20 or fewer people have been issued securities in the relevant period
 - i. Apply to facts: Clearly, offering the issuance to 50 people, even if only 20 agree, is still taking the fundraising out of the scope of the small scale
- e. If this is complied with, then there is no requirement for a disclosure statement.

2) **Is it to a sophisticated investor?**

- a. A disclosure document is not required if it is for a 'sophisticated investor' provided *s708(8)*
 - i. The minimum payment on acceptance is \$500,000; or
 - ii. A qualified accountant *s88B* provides a certificate within the last 6 months showing the person *Corporations Regulations 6D.2.03*
 - 1. has at least \$2.5 million in assets; or
 - 2. has a gross income of \$250,000 for the last two financial years. [NB: notes on calculating these values are in *s708(9)*]

3) **Sophisticated investor, buying through an AFSL? *S708(10)***

- a. A disclosure document is not required if the offer is made through *s708(10)*
 - i. An Australian financial services licensee (AFSL) provided that they are satisfied on reasonable grounds that the person being offered the securities has previous experience investing in securities and can assess *s708(10)(b)*
 - 1. Merits of the offer, value of securities, risks, adequacy of the information.
 - ii. You must issue a written statement of reasons why you are satisfied of the above criteria before or at the time of the offer *s708(10)(c)*
 - 1. Before issuing this statement, you are to make inquiries about all matters relevant to the opinion, and consider in the factual circumstances if there is reasonable grounds *ASIC v Maxwell*
 - iii. The person who receives the offer must sign a acknowledgement, at the time or before the offer is made that they have not received a disclosure statement *s708(10)(c);(d)*

4) **Is it to a professional investor? *s708(11)***

- a. Is the person a professional investor? *S708(11)(a)* as defined in *s9*
 - i. Do they have an AFSL?
 - ii. Are they regulated by APRA
- b. Does the person control over \$10 million in assets? *S708(11)(b)*
 - i. No disclosure document is required

- 5) [Senior Manager] Is it an offer of 'securities to people associated with the body' *s708(12)*
- a. No requirement for a disclosure statement if it is for
 - i. A senior manager of the body, or their spouse, parent or child or a body corporate controlled by them
 1. A senior manager includes a person taking part in the management of the company, regardless of title *ASIC Corporations Instrument 2017/737*
- 6) [employee] Offer to 'present holders of securities' i.e. dividend reinvestment or share bonus plan? *S708(13)*
- a. Is the offer of fully paid shares made to an existing shareholder in the body for the purposes of a dividend reinvestment plan or bonus share plan? *S708(13)*
 - i. If yes, then it does not need to be disclosed
- 7) Is it an offer to existing debenture holders? *s708(14)*
- a. There is no need to lodge a disclosure document unless, it is
 - i. Offers to a simple corporate bond
 - ii. Offers of debentures made to holders of simple corporate bonds
- 8) Is it an offer or sale for no consideration? *s708(15)*
- a. An offer of securities (excluding options) does not require disclosure if no consideration is provided for the issue or transfer of the securities
 - i. An offer of options does not require disclosure if: *s708(16)*
 1. No consideration is provided for the issue or transfer of the options, and
 2. No consideration is provided for the underlying securities upon the exercise of the option
- 9) Is it a compromise or arrangement under part 5.1 *s708(17)*
- 10) Is it a DOCA? *S708(17A)*
- a. Is the offer made to any or all of the company's creditors under a DOCA? – *s708(17A)*
 - i. The offer does not require the provision of consideration other than the release of the company from a debt or debts *s17A(b)*
 - b. Before the offer was specified in the deed, the administrator provided as many creditors as reasonably practicable with a statement that:
 - i. Sets out all relevant information about the offer within the administrator's knowledge *s17A(c)(i)*
 - ii. States that the statement is not a prospectus and may contain less information than a prospectus *s17A(c)(ii)*
- 11) Is it for a take over? *s708(18)*
- a. An offer, of securities does not require disclosure to investors provided the following conditions are met
 - i. The offer must be made as consideration for the offer to acquire securities under the takeover bid; and *s708(18)(a)*
 - ii. Accompanied by the bidders statement *s708(18)(b)*

12) **Is it a debenture to a certain body?** *s708(19)*

- a. **If the body is one of the following, then a disclosure statement is not required**
 - i. Australian authorised deposit taking institution; or *s708(19)(a)*
 - ii. Registered under s21 of the *Life Insurance Act 1995 s708(19)(b)*

13) **Is it an offer by an exempt body?** *s708(20)-(21)*

- a. **Exempt body corporate** *s708(20)*
 - i. An exempt body corporate is defined in *s66A*

- b. **Exempt public authority** *s708(21)*
 - i. The offer is for the issue of securities, and the body is an exempt public authority of a State or Territory
 - ii. Exempt public authority defined in *s9*