LAWS1091

Business Associations

Comprehensive Course Notes

University of New South Wales | Faculty of Law

Corporations Act 2001 (Cth) | Common Law and Equity

Week 1A: Company Types, Formation and the Decision to Incorporate

1.1 The Business Vehicle Decision

Before incorporating, a business typically operates as a sole trader or partnership. These forms expose the owner to unlimited personal liability and suffer from structural limitations that impede growth, financing and succession. The decision to incorporate involves balancing the costs of incorporation (compliance, disclosure, governance obligations) against its substantial legal and commercial benefits.

Limitations of the Sole Trader Structure
Personal liability: no distinction between personal and business assets. Business creditors can levy on the owner's house, savings and other private property.
Asset partitioning problem: because personal and business assets are commingled, business creditors must assess both the business and the owner's entire personal financial position, raising monitoring costs and restricting access to capital.
Financing difficulties: lenders face high assessment and monitoring costs. Working capital finance and long-term loan capital are harder to obtain.
Succession problems: the business is legally inseparable from the individual owner. On death or incapacity the business ceases to exist or must be wound up and its assets distributed among heirs, which may destroy going-concern value.

1.2 Types of Companies (Corporations Act 2001 (Cth))

Section 9 classifies companies by the liability of their members. The principal distinction is between companies limited by shares (most common), limited by guarantee, unlimited and no-liability companies. A further division applies between proprietary (private) and public companies.

Company Type	Key Features
Company Limited by Shares (s 112(1)(a))	Members' liability limited to the unpaid amount on their shares (s 516). Most common commercial form; may be public or proprietary.
Company Limited by Guarantee (s 112(1)(b))	Members guarantee a fixed sum if the company is wound up. Commonly used by not-for-profit organisations, clubs and charities.
Unlimited Company (s 112(1)(c))	Members bear unlimited liability for company debts. Rarely used. Useful where full flexibility is desired without any liability shield.
No Liability Company (s 112(2))	Used exclusively for mining companies. Members cannot be compelled to pay calls; unpaid shares are forfeited if calls not met.
Proprietary Company (s 45A(1))	Maximum 50 non-employee shareholders. Cannot raise capital from the public. Must have 'Pty Ltd' in its name. Lighter regulatory burden.
Public Company	May raise capital from the public (subject to disclosure obligations). Must hold AGMs. Labelled 'Ltd'. Subject to full governance requirements.

1.3 Corporate Groups

A corporate group comprises a holding (parent) company and one or more subsidiaries. Each entity within the group is a separate legal person with separate rights, assets and liabilities. Sections 46-47 of the Corporations Act define the holding-subsidiary relationship.

- Section 46: a body corporate is a subsidiary of another if: (a) the other controls the composition of its board; (b) the other controls more than half the votes in the general meeting; or (c) the other holds more than half the issued share capital.
- Section 47: a body corporate is a holding company of another if that other is a subsidiary of it.
- Corporate groups are used to ring-fence liability, facilitate joint ventures, manage regulatory requirements across jurisdictions and enable strategic acquisitions without commingling assets.

Mount Edon Gold Mines (Aust) Ltd v Burmine Ltd (1994) 12 ACSR 727
Applied the statutory test under the predecessor to ss 46-47. The court emphasised that control over board composition is the primary criterion for the holding-subsidiary relationship, and that this may exist in fact even where formal shareholding thresholds are not met. The economic reality of control is relevant to whether the statutory criteria are satisfied.

1.4 Registration of a Company (ss 117-119)

A company comes into existence as a body corporate at the beginning of the day on which ASIC registers it: s 119. Registration requires lodgment of Form 201 with ASIC under s 117, together with the prescribed information and fees.

Registration Procedure (s 117 Corporations Act)
1. Select the type of company and name. A name may be reserved via Form 410. The name must not be identical or substantially similar to an existing company name.
2. Obtain written consent of proposed members, directors and company secretary.
3. Select the registered office of the company.
4. Prepare the company's constitution, or resolve to rely on replaceable rules (or a combination).
5. Prepare the initial register of members.
6. Lodge Form 201 with ASIC and pay the prescribed registration fee (INFO 30).
7. ASIC issues a certificate of registration (s 118) setting out the company's ACN, name and type.
8. On the beginning of the day the certificate is issued, the company comes into existence as a body corporate (s 119).

1.5 Promoters and Pre-Registration Contracts

Who is a Promoter?

A promoter is a person who participates in forming and establishing a company before its registration. The Corporations Act does not define the term but courts interpret it broadly to encompass all persons who set the company formation process in motion. Professionals (lawyers, accountants, bankers) acting solely in a professional capacity are excluded.

Fiduciary Duties of Promoters

Although a promoter cannot be an agent or trustee of the company before it exists, courts extended fiduciary principles to promoters by analogy. A promoter owes fiduciary duties to the company and to persons who will become members: duty to act in good faith, avoid conflicts of interest, and make full and fair disclosure of any profit made at the company's expense.

Gluckstein v Barnes [1900] AC 240 (House of Lords)
A syndicate bought property cheaply and then sold it to a company they had themselves formed, at an inflated price. The board of directors who approved the sale were the same persons as the syndicate. The House of Lords held there had been no adequate disclosure: announcing a profit to oneself, in one's capacity as director, is not disclosure to the company. Promoters must disclose to an independent board or, if that is not possible, to all shareholders through a disclosure document. Promoters must account for all secret profits.

Pre-Registration Contracts (s 131)

Section 131(1): a person who enters a contract before a company is registered on behalf of, or for the benefit of, the company is personally bound by and entitled to the benefit of the contract. Section 131(2): once registered, the company may ratify the contract within the time agreed or a reasonable time, at which point the original contracting party is released from personal liability. If the company does not ratify, s 131(4) empowers the court to make orders allocating loss between the contracting party and the other party.

1.6 Consequences of Incorporation

Key Legal Consequences of Incorporation
Separate legal personality: the company is a distinct legal person capable of owning property, suing and being sued, entering contracts and holding rights and obligations separate from its members and directors.
Entity shielding (asset partitioning): the company's assets are separated from its members' personal assets. Business creditors can only access business assets; personal creditors can only access personal assets. This lowers monitoring costs and enables rational lending.
Limited member liability (s 516): members are only liable to pay any unpaid amount on the shares they hold. Their personal assets are protected from company creditors.
Perpetual succession: the company continues to exist independently of any change in membership or the death, resignation or insolvency of any member.
Transferable shares: shares are generally freely transferable, enabling investment without commitment to permanent membership.
Nexus of contracts: the company, not its members, is the contracting party. Directors act as agents of the company.

1.7 Shares: Financial and Control Rights

Nature of Shares

A share is a bundle of contractual rights defined by the company's constitution and the Corporations Act. Shares do not confer any property right in the underlying assets of the business. Rather, they represent a residual economic claim (after all other obligations are paid) and a bundle of control rights (primarily voting).

Ordinary vs Preference Shares

Feature	Ordinary Shares
Dividend	Residual: declared by board from available profits; no fixed rate.
Liquidation	Rank last: receive any surplus after all creditors and preference shareholders are paid.
Voting	Usually one share one vote; elect directors and vote on major transactions.
Priority	No priority over any other class.

Feature	Preference Shares
Dividend	Preferential: fixed dividend paid before ordinary shareholders; often cumulative.
Liquidation	Preferential: rank ahead of ordinary shareholders but behind creditors.
Voting	Often limited or no voting rights unless specified in constitution.
Principal	No fixed repayment date prior to liquidation (unlike debt).

Why Shareholders Hold Voting Rights

Shareholders are residual claimants: they bear the residual risk of the enterprise after all fixed claims are satisfied. This alignment of residual risk with control rights is the contractarian justification for shareholder voting. Creditors hold fixed claims and are protected by contractual covenants and security. Employees hold contractual wage claims. Shareholders, as residual risk-bearers, have the strongest interest in how the surplus is generated and are therefore given the right to elect those who manage the enterprise.