

BUSINESS ASSOCIATIONS

Semester 2, 2015

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Class 1 – Introduction

Administration Matters:

- Boros and Dunns – Simple textbook which is accepted to be accurate and clear

Assessments:

- 1-2pm Wednesday 19th August – 20 multiple choice question electronic quiz (10%)
 - Questions either in the form of a simple direct question or a little story
 - More information + practice quiz will be up 10th August
 - Class 1 – Introduction to the Course (summary) parts (2) and (3) – About the General Meeting and the Board of Directors are tailor made to the course
- Tuesday 15th September – Essay about theories (30%)
 - Discursive note about theories will be issued by Week 3
 - 2000 words (no +/- 10%)
 - 3 components – Doctrine (what is the law), Theory, and personal opinion
 - In considering the standard of care required of non-executive directors, the NSWCA in *Case*, critically assess this statement from the perspective of one of either of these 3 theories [three theories listed] , having specifically regard for s 180, 189 of the *Corporations Act*
 - Negligence = Standard of care
- Exam – 2 hours. Problem question with parts (60%)
- Class Participation – 5% maximisable... Cannot make worse but can improve

16 Important Signposts for the Course:

- (1) Doctrinal Law for the course can be found predominantly in Statute and Regulations in *Corporations Act 2001 (Cth)*, *Australian Securities and Investments Act 2001 (Cth)* and *Corporations (Fees) Act 2001*
- (2) But, the General Law (Common Law and Equity) normally applies as well- so that you may get different results depending upon which cause of action (statutory or general law) is considered
- (3) A company is a person. In most ways, even though it has no physical form, it has a personality similar to a natural person, and is capable of owning property, being a party to contracts, and being a claimant or defendant in legal proceedings
- (4) A company is a separate person from its shareholders and also directors. This is a consequence of statute and general law
- (5) A company exists solely by reason of statute: *Corporations Act 2001*. The Statute has several Chapters- by and large we tackle only a few of them
- (6) A company's existence begins when it is registered and ends when it is de-registered.
- (7) The Australian Securities and Investments Commission is where the registration is effected. ASIC is the administrator of the *Corporations Act* – commonly called the 'watchdog'. Its key Act is the *ASICA*

- (8) The owners of a company (colloquially) are its shareholders. In fact they hold shares of the share capital of the company. They do not own the company's property. They do not manage the company
- (9) The internal management of a company is governed by its constitution and the *Corporations Act 2001*. A company may have a 'tailor made' constitution or rely upon a 'default' set of Replaceable Rules provided under the Act, or have a combination of them
- (10) Shareholders may get a benefit from a company:
- (i) By receiving revenue, that is 'dividends' paid out of profits, which the company has made;
 - (ii) By their power in passing resolutions (such as to appoint and remove directors), and
 - (iii) From a capital gain if they sell their shares for an increased price
- (11) The managers of a company (and all its assets) are the directors. Shareholders have normally no right or power to tell directors how they manage the company
- (12) Corporate Governance, even though an expression of indeterminate meaning, refers to the fact that the directors have power over another person's (the company's) assets. This may be concerned with how to make sure that the directors are:
- (i) Not careless in their director's duties, (negligence); or
 - (ii) Do not use the company's assets for themselves (breach of fiduciary duties). There are some parallels to the duties of Trustees.
- (13) The General Meeting of a company refers to a formal meeting of the shareholders of the company. When they properly meet, that meeting is said to be the company so that a resolution properly passed by the shareholders is a resolution of the company
- (14) A Board Meeting is a formal meeting of the directors. When they properly meet, that meeting is said to be the company so that a resolution of the directors, properly passed, is a resolution of the company
- (15) Directors owe BOTH statutory and also 'general law' duties to the company and generally not to the 'owners' of the company (the shareholders). The usual litigants to seek to punish errant directors are 'the company' and ASIC – not the shareholders.
- (16) Shareholders may have complaints about the conduct of the company by reason of a resolution either or both at its General Meeting and by its Board of Directors. There are Statutory and 'general law' methods for shareholders to bring a case to court to hear their grievances.

Corporations:

- A company is a person → They can have rights and obligations and generally have the capacity of an individual (s 124 *Corporations Act*)
 - s 2C of the *Acts Interpretation Act* defines a person to include a body corporate as well as an individual

- Stakeholders – Anyone with an interest in the existence of a company → Main stakeholders include Shareholders, Directors and Creditors (also includes employees and the community as a whole)

3 Jurisdictions of Company Law:

- Common Law
- Equity – Historically, companies mainly derived from the exclusive equitable division over fiduciaries
- Statute – The *Corporations Act* 2001 has overtaken the case law in company law

Historical Perspective:

- Pre 1688, a corporation would have been created by the Monarch
 - The King or Queen issued a grant of charter to create a corporation → The King's consent was regarded as necessary to the erection of any corporation (This led to towns or boroughs becoming companies and owning property)
 - Exception – The Crown itself is a corporation... Created by common law and has a perpetual existence
- Historically, the common law virtually did not recognise a corporate entity, and statute was needed to create them → A private Act of Parliament effectively created the same results of incorporation as had been created by the Crown
 - The features of a modern company are essentially the features which statute gives
- Regulated company/Joint-stock companies – Were essentially partnerships... The law treated partnerships as a series of separate individuals
 - Had features of a company, but in law they were not recognised
- Statutory Corporations – At least since the 16th century, Parliament could create a corporation by Private Act of Parliament
- Main legislative movements to create the current law:
 - 1720 Bubble Act (UK) – Prohibited companies acting as corporations without being recognised by statute or charter (via the monarch)
 - 1844 Joint Stock Companies Act (UK) – Permitted companies acting as corporation once they had filed appropriate documentation and paid the correct fee
 - 1855 Limited Liability Act (UK) – Introduced the possibility that certain individuals may not be liable for the debts of others
 - Shareholder may get the benefit if the company does well, but if the company does badly, they bear the loss
 - 1856 Joint Stock Companies Act (UK) – Consolidated the 1844 and 1855 Acts
 - 1862 Companies Act (UK) – Cornerstone of Australian law. The first colonial and State Acts were based on this Act

- Stated that if 7 persons subscribed a document, a corporation is formed. s 7 of the Act allowed liability to be limited
- 1962 Uniform Companies Act – Acts separately passed in each State aimed at resulting in a national set of company law provisions
- 2001 Corporations Act (Cth) – Main current Australian law
 - Encompasses all aspects of corporations following the States decision to refer their power to the Cth

Corporations Act 2001:

s 3 – s 51(xxxvii) is the Constitutional basis for the Corporations Act, and all the rest of s 51

→ Also validated by the States referring their powers to the Cth

s 5B – Subject to the ASIC Act, ASIC has the general administration of this Act.

s 45A(2) – Small proprietary companies (cannot be registered as small/big → Only categorised)

- A proprietary company is a small proprietary company if it satisfies at least 2 of the following paragraphs (a) consolidated revenue is less than \$25 million, (b) the value of consolidated gross assets at the end of a financial year is less than \$12.5 million, (c) the company and its entitles have fewer than 50 employees

s 45A (3) – Large proprietary companies

- A proprietary company is a large proprietary company if it satisfies at least 2 of the following paragraphs (a) consolidated revenue is \$25 million or more, (b) the value of consolidated gross assets at the end of a financial year is \$12.5 million or more, (c) the company and its entitles have greater than 50 employee

s 112 – There are 6 types of company registrable under the Act

- Proprietary company: Limited by shares, unlimited with share capital
- Public company: Limited by shares, Limited by guarantee, Unlimited with share capital, no liability company (restricted to mining)

s 113 – Defines proprietary companies

- Must no more than 50 non-employee shareholders
- Cannot be publicly funded (or get public funds)

s 114 – A company must have at least 1 member → 1 person may be a company!

s 201A(1) – A proprietary company can have a minimum of 1 director

s 201A(2) – A public company must have at least 3 directors

s 115 – Once there is more than 20 partnership, a corporation must be established

s 116 – A trade union cannot be registered as a corporation

s 117 – In order to get a company, certain forms must be lodged upon application stating certain characteristics of the company (SEE SECTION FOR SPECIFIC REQUIREMENTS)

→ Explains the main requirements for the creation of a company

→ Cost of lodging an application is \$400 (*Corporations (Fees) Regulation 2001*)

s 118 – When the company is registered, ASIC gives you an identifying number

s 119 – A company comes into existence as a body corporate at the beginning of the day on which it is registered

s 601AD – A company ceases to exist on deregistration

s 120 – Members, shareholders, directors and company secretary come into existence on the day that a company is registered

s 121 – The registered office of a company is the address specified in the application for registration

s 122 – The expenses incurred before registration in promoting and setting up a company may be paid out of the company's assets

s 123 – A company *may* have a common seal (stamp which sets out ACN of the company and its name and the last 9 digits of the ABN)

s 124 - A company has the legal capacity and powers of an individual both in and outside this jurisdiction. A company also has all the powers of a body corporate (SEE SECTION FOR SPECIFICS OF WHAT THE CORPORATION MAY DO)

SEE CORPORATIONS ACT SS 45A, 112, 113, 114, 117, 118, 119, 120, 121

Class 2 – Separate Legal Personality

Essay:

- 700 words descriptive, 700 words on theories, 700 words critical voice (approx.)

Class 1 Recap:

Constitutional Basis of the Corporations Act:

- s 3 – s 51(xxxvii) is the Constitutional basis for the Corporations Act, and all the rest of s 51 → Also validated by the States referring their powers to the Cth

What is the full name of the Administrator of the *Corporations Act*?

- ASIC – Australian Securities and Investment Commission (s 5B)
- Entity which supervises the Financial Sector – APRA – Australian Prudential Regulation Authority (Casebook p. 63)

What is the proper name of the entity which runs the national stock exchange?

- ASX – Australian Securities Exchange (Casebook p. 63)

What is the name of the case in which the HCA said that the 1991 National Corporations Act was found to be unconstitutional?

- *Re Wakim* (Casebook p. 50)

How would you register a mining company?

- No liability company → (CA s 112)

What is the number for revenue which is critical for both large and small proprietary companies?

- s 45A(2) – Small proprietary companies, s 45A(3) – Large proprietary companies
 - \$25 million revenue, \$12.5 assets, 50 employees (2/3 required)

What 2 things have to be met in order to be registered as a proprietary company?

- Can't have more than 50 non-employee shareholders, Can't have any public funding

What is the largest number of partners that a business can have before registration is required? 20

Name 5 things which must be included in the registration of a corporation:

- See s 117 CA!

Who gives a company its registered number?

- ASIC – Australian Securities and Investment Commission

Limited Liability:

- **EG:** 5 people agree to make a business. 2/5 will run the business (directors), 1/5 will control the finances, and the other 2/5 are going to do nothing
 - Company must be registered by filing in the necessary paperwork (s 117 CA)
 - Must agree in advance how many shares the company is going to have, the amount they will each pay for the shares, (s 117 (k)) → 100 shares in this example, with each having equal amount of 20 at a cost price of \$5 per share (\$100 each, giving the company \$500 → Minus \$90 owed from B)
 - B's only pays \$10, owes \$90 (thus they are only partly paid shares)
 - The company is obliged to keep a register of shareholders and the shares which they hold
 - At common law (not equity), one is only a shareholder once registered!
 - B sells the shares to Z, they remain partly paid
 - Company comes into existence on the morning of registration → 6 entities have an interest in the company (5 individuals + the corporation)
 - Company owes money to creditors... Company goes bust and can't repay the bill → Shareholders (fully paid) have no obligation to pay the creditors
 - Partly paid shareholders have an obligation to repay the amount which is still owing from the original sum (in this case \$90)
- **Limited liability** means that fully paid shareholders are not liable to personally repay any amount of business loss to creditors
 - EXCEPTION – Partly-paid shareholders must repay what they still owe

The nexus between corporate personality and limited liability:

- Shareholders and directors have limited liability for the risk of a business → This responsibility falls upon creditors
 - Limited liability shifts the risk of enterprise operations away from shareholders and onto stakeholders or wider society

The merits and costs of limited liability:

- Several arguments may be advanced in favour of limited liability:
 - It encourages investment by those who have no interest in or capacity for management participation
 - It relieves shareholders from the burden of monitoring fellow shareholders capacity to contribute proportionately to company failure
 - It encourages free liquidity of share capital
 - It encourages entrepreneurial risk taking by companies since they may safely invest in projects with prospects of positive returns but also those with significant risk exposure

Corporate Personality:

The special character of corporate personality:

- While a registered company is invested with the legal capacity and powers of an individual (s 124 CA), its incorporeal nature ensures that there is no temporal limit upon its existence → It essentially has no conscience
 - Is incapable of personal appearance in court, must appear through a rep
 - A corporation is not entitled to invoke the common law privilege against self-incrimination in answer to a demand for the production of documents under statutory power (*Environmental Protection Authority v Caltex Refining Co*)

The separate personality of the corporation:

***Saloman v Saloman & Co Ltd* [1897] AC 22 HOL:**

- **Facts** – Aron Saloman had traded on his own as a leather merchant and wholesaler boot manufacturer. He arranged for incorporation and arranged for himself to hold 20 001 shares, with his wife and 5 children also each holding 1 individual share in trust (so that the legal requirements were satisfied)
 - The company went bust, claim was made that the company was not actually a company at all due to the 6 shareholders being essentially dummy's to satisfy legal requirements
 - Saloman claims/estimates to own stock worth £38k... Wants to sell it to the company (who does not have £38k)
 - **Facts** - Downturn in the economy, creditors become involved to recoup the debt which is owing → Claims to recoup from Salmon (as a shareholder) in fraud by claiming that the company is a sham
 - **s 95A(1) CA** – A person is solvent if they are able to pay all the persons debts as and when they become payable
 - **s 95A(2) CA** – A person who is not solvent is insolvent (Saloman company insolvent as they could not pay their debts)
- **Issue** – Was Saloman & Co a company or a sham to avoid personal liability? Is Saloman individually liable for the debts of the business?
- **Held (Lord Halsbury LC)** – The sole guide in determining the status of a corporation must be the statute itself
 - The 6 family members were valid shareholders as the statute states that one share is enough
 - It was impossible to deny the validity of the transactions into which were entered → No fraud in having 6 shareholders with only 1 share and thus the company is a real one (each shareholder assented to the arrangement!)
- **Held (Lord MacNaghten)** – There was nothing in the statute requiring the shareholder to be independent or unconnected nor requiring them to take a substantial interest in the undertaking → Company was valid!
 - Shareholders had full notice that they were no longer dealing with the individual, but rather a company
- **Decision** – Company was valid. Statute itself indicates requirements for a corporation

- **Ratio** - The company is at law a different person all together from the subscribers to the memorandum (the shareholders) and though it may be that after incorporation the business is the same as it was before, the **company is not in law the agent** of the subscribers or trustee for them, nor as the subscribers liable in any shape or form
 - Basis of doctrine has since been confirmed in s 156 CA
 - Company and the shareholders are separate entities → Shareholders are not liable for the debts of the company providing there is no fraud

Lee v Lee's Air Farming Ltd [1961] AC 12 Privy Council:

- **Facts** – Lee formed a company. He held the whole of the issued capital in the company except for one share held by his solicitor.
 - Lee enjoyed full and unrestricted control over the affairs of the company however was killed while carrying out work
 - Lee's widow sued the company for compensation however the NZCA rejected the application on the basis that Lee (as director) could not be under a contract of service as he had the full control of the company
- **Issue** – Could Lee be both a director and servant of the corporation?
- **Held (Lord Morris)** – Lee was paid for his work in partaking the business of ariel top-dressing... It cannot be suggested that when he engaged in the activities that caused his death he was discharging his duties as governing director
 - Appointment was valid as Lee acting as the agent of the company in arranging the appointment
- **LAW** – It is well established that the mere fact that someone is a director of a company is no impediment to his entering into a contract to serve the company
 - His capacity as a shareholder who is able to control the course of events would not in itself affect the validity of his contractual relationship with the company → Logical conclusion to assert that one person may act in dual capacities
- **Decision** – Director role does not alter Lee's contractual role as a servant → The company and Lee were two separate and distinct legal persons
 - A company can give an order to a majority shareholder!
- **Ratio** – It is the logical consequence from the decision in *Saloman's Case* that one person may function in dual capacities

Hamilton v Whitehead (1988) 166 CLR 121:

- **Facts** – Whitehead is the managing director of a small Pty company (s 113 – Cannot raise public funds). Company attempts to raise public funds by sending out brochures. Whitehead is charged with contravening the law, as he assisted the breach of the law
- **Issue** – Who is liable? The company or Whitehead?
- **Held** – There are two capacities for Whitehead → One as an individual and another as a corporation
 - Case is HCA confirmation of *Lee v Lee's Air Farming* principle

***Macaura v Northern Assurance Co* [1925] AC 619**

- **Facts** – Macaura was the only shareholder of a timber business. Timber business was sold into a company, Macaura is no longer the individual owner of the timber, the company is
 - Insurance policy was taken out in Macaura's personal capacity, and was not transferred to his company
 - Wood catches fire, Macaura attempted to claim insurance by asserting that he is an individual
- **Issue** – One legal entity or two?
- **Held** – Macaura was protected as the company was essentially the same as his individual self → Not able to establish two separate legal entities
 - HOL decision that indicates the separate legal personality doctrine works both in favour of corporations and shareholders

Gower's Principles of Modern Company Law:

- Since the *Saloman* case, the complete separation of the company and its members has never been doubted!
 - If a trader sells his business to a company he will cease to have an insurable interest in its assets even though he is the beneficial owner of all shares

Cheffins, B Company Law: Theory, Structure and Operation (1997)

- Case law indicates that a company is an entity which is distinct from those who run it
 - In a financial sense, creditors bear much of the risk associated with business failure
- Concerns associated with limited liability:
 - Shareholders have an incentive to gamble with creditors money
 - The distribution of loss as between creditors seemingly prejudices those who are least able to endure the consequences
- Positive attributes of limited liability:
 - Facilitates the operation of equity markets → Owning a diversified portfolio of shares is a sensible risk-reduction strategy
 - Limited liability helps to distribute risk away from poor risk bearers in favour of those better positioned to deal with the consequences

