

COMPANY LAW NOTES

COMMONLY USED VOCABULARY

Verb (Noun)	Definition
Enforce (enforcement).	Implement; action a legal requirement.
Contravene (contravention).	Any breach of the law.
Incorporate (incorporation).	To create a body corporate.
Evade (evasion).	To avoid.
Liable (liability).	Any legal responsibility, duty or obligation.
Proceed (proceedings).	Legal action.
Disclose (disclosure).	Make known.
Expropriate (expropriation).	Take or take over.
Comply (compliance).	Obey to fulfil the requirements of the law.
Repeal.	Take back.
Adopt (adoption).	Take on.
Bind, binding, bound.	Required obligatory.
Resolve (resolution).	Decide, a decision or motion passed at a meeting.
Assume (assumptions).	Presume, accepted as true.
Vary (variation).	A change; to change.

CHAPTER 1 - ABOUT COMPANIES

COMPANY ~

An artificial person created by the law. The function of a company in a legal sense is to hold assets (property) and to carry on a business or other activity, as an entity separate from its participants (investors, managers) in that business or activity. Corporations are formed by being registered under the Corporations Act.

SEPARATE LEGAL ENTITY ~

A company is treated as a separate person from those who participate in the company. It has its own legal identity or personality (it can hold property in its own name and enter into contracts in its own name), and its liabilities are its own and not those of its members or officers. A company comes into existence as a body corporate at the beginning of the day on which it is registered. The company's name is the name specified in the certificate of registration (*s 119*).

LIMITED LIABILITY ~

Even if a company is unable to pay all of its liabilities, then those participants who have invested money in the company are not liable to contribute any more than what they have paid (or agreed to pay) to acquire their shares in order for the company to meet those liabilities.

REQUIREMENTS ~

1. All companies must have at least one member (in the case of a company limited by shares, the member will hold at least one share in the company).
2. All companies must have at least one director, who is responsible for managing the company's business.
3. Most proprietary companies and all public companies must have a secretary (who has certain administrative responsibilities to fulfil).

SHARE ~

Represent a number of rights that may or may not (depending on the terms of issue of the share) include control rights (such as voting rights and rights to receive information) and distribution rights (such as a right to receive dividends or to share in the assets of the company on a winding up of the company).

MEMBER ~

They are the people (owners or proprietors) who have invested money with the company in the expectation that they will receive a return on their money if the company is successful, either in the form of distributions (dividends) paid out by the company during its trading life or in the form of growth in the value of their investment in the company over time. A member does not have to

be a natural person but may itself be a company. It is possible to form or operate a company with only minimal paid up capital.

EXECUTIVE DIRECTOR ~

Are those who are employed by the company and devote all or substantially all of their working time to managing the company's affairs.

NON-EXECUTIVE DIRECTOR ~

Are not employed in the company's business and provide an outsider's contribution and oversight to the board of directors.

INTERNAL GOVERNANCE RULES ~

The rules agreed by the members of the company that govern matters connected with its internal administration. A company's internal governance rules will consist of the replaceable rules set out in the Corporations Act and a constitution.

LISTED COMPANY ~

Is a company that has its shares listed for quotation on the ASX. Members of the public can buy and sell shares in the company through the stock market operated by the ASX.

PROPRIETARY COMPANY ~

Is not permitted to have more than 50 members or to raise money by conducting a public offer of shares. Are exempted from many company law rules that are designed to protect investors who do not participate actively in the operation of the business. Are not allowed to undertake certain fundraising activities that require the issue of a prospectus. Are required to have at least one director.

PUBLIC COMPANY ~

Have wider powers to raise capital from members of the public than proprietary companies, but are subject to more onerous regulations. Must have a secretary and at least three directors.

CHAPTER 2 - COMPANY LAW

CONTACT ~

A person may come to deal with a company voluntarily, where the person elects to enter into a legal relationship with that company (through entering into a contract with the company). A person may involuntarily come to deal with the company where the company commits a wrong that affects the person and the wrong is capable of legal remedy.

BREACHES ~

If a person or company breaches one of these rules of company law then, depending upon which rule is breached, one or both of the following may result:

1. Person may be made subject to a public law section, such as a fine or term of imprisonment.
2. Person or company may be stopped from engaging in the wrongful conduct or required to do some further act or thing, or required to compensate any person harmed by the breach (paying damages).

CORPORATIONS ACT ~

Regulates takeovers, provides for the registration and operation of managed investment schemes, and sets out the licensing and disclosure rules that apply to financial products, financial services and financial markets. Is the statute governing the creation, operation and termination of companies in Australia.

ASIC ~

Is the main regulator of companies and the body responsible for carrying out the administrative functions set out in the Corporations Act.

FUNCTIONS ~

- Registering companies.
- Gathering and disseminating information about companies.
- Educating companies and individuals about the law.
- Modifying the Corporations Act in certain circumstances.
- Registering company auditors and liquidators.
- Investigating breaches of the law.
- Enforcing the law.

CHAPTER 3 - LEGAL NATURE OF COMPANIES

SEPARATE LEGAL PERSONALITY ~

Between the investor, who participates as a shareholder, and the undertaking carried on, the law imposes another person, real through artificial, the company itself, and the business carried on is the business of the company, and the capital it employs is its capital and not in either case the business or the capital of the shareholders.

CONSEQUENCES ~

- A company's obligations and liabilities are its own, and not those of the participants (creditors of a company are unable to look to the participants in the company to pay the company's debts).
- A company can sue and be sued in its own name (s 119).
- A company has perpetual succession (is a continuing entity in law with its own identity regardless of changes in its membership).
- A company's property is not the property of its participants (*Macaura v Northern Assurance Co Ltd*).
- A company can contract with its controlling participants (*Lee v Lee's Air Farming Ltd*).

BENEFITS OF LIMITED LIABILITY ~

- Encourage risk taking and entrepreneurial behaviour by enabling investors to quarantine their wealth from particular risky undertakings.
- Decrease the need for shareholders to monitor the managers of companies in which they invest.
- Provide incentives for managers to act efficiently and in the interests of shareholders by promoting the free transfer of shares.
- Assist the efficient operation of the securities markets because the prices at which shares trade do not depend upon an evaluation of the wealth of individual shareholders.
- Permit efficient diversification by shareholders.
- Facilitate optimal investment decisions by managers.

VICARIOUS LIABILITY ~

An employer (whether it is a company or not) is liable vicariously for the acts and omissions of its employees, provided that the employees are acting within the scope of their employment.

DIRECT LIABILITY ~

Where a company is treated as having committed a tort itself (*Lennard's Carrying Company Ltd v Asiatic Petroleum Company Ltd*).

CHAPTER 4 - COMPANIES AND BUSINESS PLANNING

SOLE TRADER ~

An individual person carries on a business in his or her name. There is no separation between the business and personal assets or obligations of the person conducting the business. The sole proprietor signs all contracts, owns its assets and is personally liable for all its debts.

PARTNERSHIP ~

An association of people carrying on business in common with a view to a profit. There is no need to take any formal steps to create a partnership (terms of the agreement between partners are recorded in a formal legal document). Is not a separate legal entity. Partners do not have limited liability. An individual partner can incur an obligation for which all the other partners are also responsible. The profits and losses generated are taxable in the hands of the individual partners, and can be offset against their other income. Partnerships with more than 20 partners are not permitted.

TRUST ~

Arises where one person is required to hold or invest property for the benefit of another person. The person who holds the property is the trustee, and the people who are entitled to enjoy the property and receive the income or other proceeds from it are the beneficiaries. Is not itself a legal entity. Trustees are personally liable for debts incurred on behalf of the trust.

ADVANTAGES OF A COMPANY ~

- Limited liability.
- Perpetual succession (a company's existence continues indefinitely until it is bought to an end).
- Free transferability of investor or owner's interests (owner's interest in the company is shares in the company and these can be transferred).

- Able to act as a large commercial enterprise.
- Corporate law is enacted between participants (reduced costs and uncertainties).
- Lower income tax rate.
- Contractual capacity.
 - 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, including the power to (s 124(1)):
 - a) Issue and cancel shares in the company.
 - b) Issue debentures.
 - c) Grant options over unissued shares in the company.
 - d) Distribute any of the company's property among the members, in kind or otherwise.
 - e) Grant a security interest in uncalled capital.
 - f) Grant a circulating security interest over the company's property.
 - g) Arrange for the company to be registered or recognised as a body corporate in any place outside the jurisdiction.
 - h) Do anything that it is authorised to do by any other law.

CORPORATE VEIL ~

Is an expression that lawyers use to describe the legal rules that keep participants (members, officers) separate from the company in a legal sense.

The effect is that it stops the law from seeing the participants that make up the company (owners and operators). Means that the law cannot look through the veil of incorporation and say that the company's obligations, liabilities, rights or property are obligations, liabilities, rights or property of the participants.

DISADVANTAGES OF A COMPANY ~

- Significant establishment and administration costs.
- Publicity (required to disclose information).
- Public law obligations.
- Enforcement by ASIC (can regulate, scrutinise and penalise).

PUBLIC COMPANY OBLIGATIONS ~

1. Required to hold an annual general meeting (s 250N).
2. Required to lodge financial reports regardless of the size of the company's operations (s 292).
3. Must have at least three directors (s 201A).
4. Must have a secretary (s 204A).
5. Resignation by auditor of a public company requires the consent of ASIC (s 329).

ADVANTAGES OF A PROPRIETARY COMPANY ~

- Resolutions of proprietary companies that must be passed at general meetings of shareholders may be deemed to have been passed even though no meeting was held, provided all shareholders sign a document stating that they support the resolution (s 249A).
- Corporations Act imposes more onerous obligations on public companies and their participants.

SMALL PROPRIETARY COMPANY ~

1. If consolidated gross operating revenue for the financial year of the company and the entities it controls is less than \$25 million.
2. Value of consolidated gross assets at the end of the financial year is less than \$12.5 million.
3. If the company has fewer than 50 employees at the end of the financial year.

PROCEDURE TO CHANGE TYPE ~

1. The company must pass a special resolution to change its type and then comply with various registration requirements, including providing information to ASIC.
2. If the change of type is one permitted under the Corporations Act, ASIC will then alter the details of the company's registration to reflect the change of type.
3. The change does not create a new legal entity or affect the company's existing relationship with outsiders (s 166).

CORPORATE GROUP ~

Where control of one or more companies is in the hands of another company. Controlling company is the holding company and controlled company is the subsidiary.

SUBSIDIARY ~

A body corporate is a subsidiary of another body corporate if, and only if (s 46):

- a) The other body:
 - i. Controls the composition of the first body's board.
 - ii. Is in a position to cast, or control the casting of, more than one-half of the maximum number of votes that might be cast at a general meeting of the first body.
 - iii. Holds more than one-half of the issued share capital of the first body (excluding any part of that issued share capital that carries no right to participate beyond a specified amount in a distribution of either profits or capital).
- b) The first body is a subsidiary of a subsidiary of the other body.

Wholly owned subsidiary is where all its issued shares are held by a holding company.

BENEFITS OF A CORPORATE GROUP ~

- Perceived organisational benefits in separating out the management of different aspects of the enterprise.
- A wish to rely on the doctrine of limited liability to quarantine the risk of one part of the enterprise from the assets of the remainder.

CONTROL ~

An entity controls a second entity if the first entity has the capacity to determine the outcome of decisions about the second entity's financial or operating policies (s 50AA).

RULES FOR A CORPORATE GROUP ~

1. Insolvent trading (a holding company may be liable for debts incurred by a subsidiary after the subsidiary became insolvent, s 588V).
2. Related party transactions.
3. Financial statements (the accounting rules for company financial statements and reporting allow for the preparation of consolidated or group financial statements, and for group reporting and disclosure).
4. Large and small proprietary companies (the assets and operations of companies and entities controlled by them are taken into account in determining whether a particular company is a small or large proprietary company).
5. Directors' duties (a director of a wholly owned subsidiary is allowed to act in the interests of the parent company in some circumstances, s 187).

A director of a company that is a wholly owned subsidiary of another company is to be taken to act in good faith in the best interests of the subsidiary if (s 187):

- a) The constitution of the subsidiary expressly authorises the director to act in the best interests of the parent company.
- b) The director acts in good faith in the best interests of the parent company.
- c) The subsidiary is not insolvent at the time the director acts and does not become insolvent because of the director's act.

PRE-REGISTRATION ~

If a person enters into, or purports to enter into, a contract on behalf of, or for the benefit of, a company before it is registered, the company becomes bound by the contract and entitled to its benefit if the company, or a company that is reasonably identifiable with it, is registered and ratifies the contract s 131(1):

- a) Within the time agreed to by the parties to the contract.
- b) If there is no agreed time (within a reasonable time after the contract is entered into).

The person is liable to pay damages to each other party to the pre-registration contract if the company is not registered, or the company is registered but does not ratify the contract entered into a substitute for it (s 131(2)):

- a) Within the time agreed to by the other parties to the contract.
- b) If there is no agreed time (within a reasonable time after the contract is entered into).

The amount that the person is liable to pay to a party is the amount the company would be liable to pay to the party if the company had ratified the contract and then did not perform it at all.

CHAPTER 5 - CONSTITUTING COMPANIES

CREATING A COMPANY ~

Companies are incorporated through being registered by ASIC. A person wishing to create a company lodges an application for registration with ASIC and pays the prescribed fee. The application form must contain certain information about the new company. A company's existence comes to an end when it is de-registered.

PROCEDURE ~

1. Person proposing to register the company will need to decide whether the company will be a proprietary company or a public company.
2. Decide who will be the members of the company.
3. Planners will also need to decide the number of shares to be taken up by each member and whether those shares are to be divided into different classes.
4. Proposed members must consent in writing to becoming members of the company (*s 231*).
5. Decide who will be the director or directors of the company.
6. Directors must give their consent in writing to being appointed as directors (*s 120*).
7. Decide who will be the secretary or secretaries of the company; choose an address to be the company's registered office (*s 121*).
8. Decide whether the company's internal arrangements will be governed by the replaceable rules or whether a constitution replacing some or all of those rules is to be adopted (*Pt 2B.4*).
9. Choose a name for the company (*Pt 2B.6*).

MATTERS OF INTERNAL GOVERNANCE RULES ~

- Appointment, removal and powers of the company's officers.
- Procedure for convening and conducting directors' meetings or members' meetings.
- Any special rights attaching to classes of shares.
- Rules relating to dividends.
- Rules relating to the transfer and transmission of shares.

REPLACEABLE RULES ~

Replaceable rules can replace what is in the Corporations Act with the company's own rules. The business of a company is to be managed by or under the direction of the directors (*s 198A(1)*). The director's may exercise all the powers of the company except any powers that this Act or the company's constitution requires the company to exercise in general meeting (*s 198A(2)*):

- a) If the company was formed on or after 1 July 1998, it may make that election simply by not adopting a constitution.
- b) If the company was formed before 1 July 1998, it can invoke the replaceable rules by repealing its existing memorandum and articles of association (*s 135*).
- c) The replaceable rules apply to a company unless displaced or modified in accordance with *s 135(2)* by operation of *s 135(1)*.

ULTRA VIRES RULE ~

The ultra vires rule states that the incorporated company is a creation of law and provided that a transaction which was not clearly within the scope of the objects clause was to be regarded in law as void from the beginning. The rule was made to ensure that subscribers and later shareholders were protected from the misapplication of share capital.

CONSTRUCTIVE NOTICE RULE ~

The rule provides that a person dealing with a company was deemed to be aware of the objects of the company. However, the rule operated to the extent that it resulted not simply in transactions being rendered wholly void and unenforceable by either the company or the party contracting with the company, but rendered them being incapable of being ratified by unanimous vote of the company's shareholders.

BENEFITS OF A CONSTITUTION ~

- To substitute different rules for some or all of the replaceable rules.
- Supplement the replaceable rules and to address matters not covered by them.
- Collect all of the internal governance rules into a single document, for the convenient reference of officers and members.
- Ensure that, if parliament amends a replaceable rule, that amendment does not take effect unless it is specifically adopted by the company.
- Avoid legal uncertainty about certain aspects of the replaceable rules.
- Meet the requirements of the ASX Listing Rules.
- Incorporate restrictions on the company's objects.

AMENDING A CONSTITUTION ~

1. Amendment to and repeal of the constitution are governed by *s 136* and *s 137*.
2. Amending or repealing a company's constitution requires a special resolution of members (*s 136(2)*).

3. In passing a resolution to amend or repeal a constitution, the members are bound by the rules governing the exercising of their voting rights and the provisions of the Corporations Act governing variation of class rights.
4. Where a company has passed a resolution to amend or repeal a constitution, that resolution will take effect on the day it is passed or on a later date specified on the resolution (s 137).
5. Public companies that amend or repeal their constitution must give notice to ASIC (s 136(5)).

EFFECTS OF INTERNAL GOVERNANCE RULES ~

A company's constitution and any replaceable rules that apply to the company have effect as a contract (s 140):

- a) Between the company and each member.
- b) Between the company and each director and company secretary.
- c) Between a member and each other member.

ENFORCEMENT ~

- Internal governance rules do not operate as a contract between a member and an officer, or between an officer and another officer.
- Furthermore, the contract cannot be enforced by outsiders.
- Member is bound and entitled only in its capacity as a member.
- Member cannot enforce compliance by the company with a procedural requirement in the internal governance rules where failure to comply with that requirement can validly be excused by a majority of members in general meeting.