

Company Law

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Module 1 – Introduction to company law

- Choice of the type of business structure
- Development of Australian company law
- Incorporation process
- Characteristics of a company
- The company as a separate entity
- The corporate veil
- “Promoters”
- Pre-incorporation contracts

Choice of the type of business structure

- A business may be owned and operated by:
 - Sole personal proprietorship (note use of business names)
 - Partnerships
 - Joint ventures
 - Trading trusts (should already be aware of this from the trusts course – should remember that trustee is usually a company anyway)
 - Company

Why choose a company?

Firstly what are The advantages?

- Efficient way to attract and use investor funds
- It is a separate legal entity that can do everything at law that an individual can do
- Limited liability for its members (with the exception of “unlimited” companies – rare)
 - Investors will only lose what they invest and nothing more (some exceptions)
 - Even better for no liability companies
- It is immortal! Can live forever

Incorporation process: How to create a company

1. Need to firstly select the type of company (s112):
 - + Note the fundamental difference between public and proprietary companies
 - + Proprietary -“Pty Ltd” could be: (s113)
 - × limited by shares; or
 - × unlimited with share capital
 - + Public - “Ltd” could be: (s9)
 - × limited by shares;
 - × limited by guarantee;
 - × Unlimited with share capital; or

No liability company (ie mining company)

2. Need to select a name (ss147,148,152) that is available and not unacceptable for other reasons
 - + Note the distinction between having a name for a company and a registered business name
3. Need the consent of the proposed members and the directors and secretary (s117)
4. Need a registered office (s142)
5. Prepare your own constitution or rely upon the “replaceable rules” (s135/136)
6. Lodge application (s117), pay fees and receive certificate of registration (s118) – Company given an CAN

Shelf companies

- Common for people to simply purchase “shelf companies” ie companies that are already registered
- Owners simply transfer shares to buyers for a fee
- Obtain the relevant consents from new directors and previous ones resign
- Change the address to the new registered office
- Change the name to one that you can obtain approval for

Characteristics of a company

- ✗ Once registered a company becomes a separate legal entity distinct from members/shareholders and directors/officers.
- ✗ This means there is a “veil of incorporation” ie. subject to some exceptions there is no need for the law to look behind the company to see who owns or controls it – Will look at cases where the law will lift the veil
- ✗ The company can hold property, sue in its own name and otherwise do anything at law that an individual can do – refer to s124
- ✗ Limited liability is an important feature. Not for the company. The members usually have limited liability ie liability limited to the value unpaid on any shares.

The company as a separate entity

- It is vital that you visualise the company (although it does not physically exist) as being a legal person distinct from those that cause it to act. Because the company has no physical presence it usually only acts through people as agents but those acts can still be the acts of the company.
- *Salomon v Salomon & Co Ltd* [1897] AC 22
- *Lee v Lee’s Air Farming* [1961] AC 12

The corporate veil

- Ever since *Salomon v Salomon* confirmed the existence of the corporate veil the courts have recognised the need to look behind it from time to time to do justice. The legislature too has intervened in specific areas
- Lifting the corporate veil by statute:
 - Directors liability for insolvent trading: s588G
 - Parent company liable for debts of insolvent subsidiary: s588V
 - Director of trustee company personally liable if they cause the company to lose the right of indemnity from the trust; s197
 - Uncommercial transactions by a company prior to its winding up may be set aside in certain circumstances: s588FB, s588FE
 - Invalidating charges/security granted to officers: s588FP
 - Where the company finances the acquisition of its own shares: s260A
 - Taxation legislation
- Lifting the corporate veil at common law:
 - Fraud
Re Darby [1911] 1 KB 95
 - Avoidance of legal obligations
Gifford Motor Co Ltd v Horne [1933] Ch 935
Creasey v Breachwood Motors Ltd [1992] 10 ACLC 3,052
 - Involvement in directors’ breach of duty
Green v Bestobell Industries Ltd [1982] WAR 1
 - Subsidiaries as agents or partners
Smith, Stone & Knight Ltd v Birmingham Corporation [1939] 4 All ER 116
 - Parent company liable for subsidiary’s torts
Briggs v James Hardie & Co Pty Ltd [1989] 7 ACLC 841
 - Where the reality is that companies are acting in best interests of corporate group
Equiticorp Finance Ltd v Bank of New Zealand [1993] 11 ACLC 952

“Promoters”

- Before we consider the operations of a company once it is formed it is necessary to consider the very special circumstances where liabilities and obligations can arise for the company and individuals even before the company exists
- Promoters are those people who are involved in the formation of the company.
Twycross v Grant (1877) 2 CPD 469
- It usually becomes an issue to consider their role because they may have attempted to contract on behalf of the company they are setting up ie. pre-incorporation contracts

- If you are actively undertaking the formation of the company you will be a promoter. But may also cover passive persons who direct others
Tracy v Mandalay (1953) 88 CLR 215

Duties of promoters

- Promoters can easily abuse their relationship with the company and so courts have long recognised they have a fiduciary duty to act bone fide in the interests of the company and avoid conflicts of interest
- They must make full disclosure of any interest they have in any contract affecting the company – regardless of their honesty or if they make any profit
Erlanger v New Sombrero Phosphate Co (1878) 3 App Cas 1218
- They must also disclose any personal profits they make in the position
Gluckstein v Barnes [1900] AC 240
- Disclosure should be to an independent board. If this is not possible it should be made to members

Remedies for breach of duty

- ✗ Rescission
 - + Company may be able to rescind contract unless
 - ✗ Company does not act promptly upon discovery
 - ✗ Company had affirmed it after discovery
 - ✗ Restitution impossible (eg property altered)
 - ✗ It affects innocent third parties with an interest
- ✗ Damages
- ✗ Recovery of secret profits
 - + Can recover profit regardless of ability to rescind
 - + *Gluckstein v Barnes* [1900] AC 240
 - + Could be achieved with use of constructive trust

Pre-incorporation contracts

- ✗ A promoter may seek to contract on behalf of the company with a third person on the basis that the company will be formed. Time may be of the essence and/or in any event the desire is that the company will ultimately take responsibility
- ✗ **At common law**
 - + This would be impossible.
 - + Because at the time of the contract the agent (the promoter) would be purporting to represent a principal that does not exist.
 - + If the principal did not exist at that time where does the agent get their authority from?

The effects of s131

- ✗ To be effective the promoter must:
 - + Purport to enter into the contract on behalf of the company (as agent) before it is registered
 - + Company which is incorporated must be reasonably identifiable with the one purported to be a party to the contract
 - + Company needs to ratify the contract within an agreed or reasonable time
- ✗ If all this occurs the company becomes bound to the contract even though it did not exist at the time of its creation: s131(1)
- ✗ If this does not occur the third party will have a personal action against the promoter: s131(2)
- ✗ If company is formed but does not ratify the court may order it to pay damages or transfer property etc – usually where company will get a benefit from contract that they do not want to pay for: s131(3)
- ✗ If company is formed and does ratify but fails to perform the court could still order the promoter to pay damages: s131(4)
- ✗ It is possible that the third party might agree to release promoter from any personal liability at the time of the contract: s132

MODULE 2: THE CORPORATE CONSTITUTION

1. “Corporate Governance Rules”; The “Constitution” and “Replaceable Rules”

- Originally the rules that governed what the company would do (its objects) and how the company would do it were contained in the documents the company registered when formed:
 1. The Memorandum of Association; and
 2. Articles of Association