

## TOPIC 1: INTRODUCTION

### 1.1 WHAT IS A COMPANY?

#### Historical development of the corporate form

- The joint stock company is a hybrid growth... a partnership which has been invested with the character of incorporation and the rules which are applicable are partly referable to both characters.
- **The recognition of corporate persons:**
  - Corporations are legal persons, rights and duty bearing units.
  - They were persons created by the law, distinct from their human members. They were immortal and invisible. They could commit neither sin nor crime, and some said no tort – truly suitable representatives for saints and churches.
  - Corporations aggregate: consists of many persons united together into one society and are kept up by a perpetual succession of members. Corporations sole consists of one person only and his successor, in some particular station, who are incorporated by law, in order to give them some legal capacities and advantages, particularly that of perpetuity. (eg. King is a sole corporation)
  - Recognition of corporate persons included recognition of 3 principles:
    - A corporation is a person distinct from its members
    - The property of the corporation is distinct from the property of its members
    - The property of its members cannot be taken into execution for the debt of the corporation, and vice versa.
  - Boroughs and Guilds:
    - From the 13<sup>th</sup> Century, boroughs were granted franchises by royal charter, conferring privileges upon the municipal group. This may include jurisdictional privileges, limited powers of self-government, including power to pass by-laws and impose taxes. Also included the right to perpetual succession, the right to sue and be sued in the group name, the power to hold lands and the right to use a common seal to identify acts on behalf of the borough.
    - Eg. Merchants
  - Chartered corporations:
    - The guild's functions were succeeded by chartered corporations to regulate trade in the public interest. The early form of charters was effectively a limited purpose guild, where merchants engaged in foreign trade on their own account and risk, subject to regulations passed by the company.
    - Eg. Monopolies
    - Chartered joint stock companies had an enduring effect:
      - Voting power of members of the company should be based upon the size of their shareholding and not upon the 'one person, one vote' principle of the guilds.
      - Governors and associates of the companies (directors) were held to the rigorous trustee standard of disinterested service. The treatment of the managing body as fiduciaries is a central principle of modern company law.
      - Company possesses a personality distinct from that of its members, a concept of central importance to modern company law and underlying many of its doctrines.
  - South Sea Bubble:
    - By the 17<sup>th</sup> century joint stock companies made their stocks freely transferable. An organized stock market was established.
    - The South Sea Company, was formed in 1711 to secure the trade, largely in slaves to South America. It was granted monopoly rights with respect to trade to South America. The company's shares went from \$100 to over \$1000. There was a government scheme where it acquired the national debt in the form of annuities for shares.
    - The Bubble Act passed in June 1720 to staunch irrational exuberance. It prohibited the acting or presuming to act as a corporate body and the raising or pretending to raise transferable stocks in

either case without legal authority, either by Act of Parliament, or by any charter from the Crown.

- Deed of settlement company:
  - The Bubble Act was repealed in 1825.
  - The birth of the deed of settlement, which provided members the principal corporate advantages, but without benefit of incorporation.
    - This included articles of association, which was in the form of a deed of settlement signed by those participating in the society.
    - **The deed constitutes certain persons as trustees of the partnership property. It contains regulations relating to the management of private affairs of the company.**
  - By the 19<sup>th</sup> Century three forms of association were available for business activity: The Partnership, The unincorporated joint stock company formed by a deed of settlement and the recent innovation of the company incorporated by private Act of Parliament.
  - In 1856, a consolidated statute provided for incorporation on the application of seven persons. The deed of settlement gave way to two constitutional documents, the memorandum of association and the articles of association.
- The corporation is an organizational structure that facilitates the raising of finance for business activity from those with capital for investment but no interest or capacity for management of that business. This usually includes professional managers with business or technical skills but inadequate personal wealth to fund the venture. The suppliers of long-term capital (shareholders) thus share in the financial gains of the enterprise without having to participate in its management.

#### Theories and conceptions of the corporation:

- **The corporation as contract (Shareholder theory)**
  - Contractarian theories were stimulated in 1970 where it was no more than a 'nexus of contracting relationships' between shareholders, managers and other employees, lenders, supplier and other stakeholders.
  - This was seen as the **optimal firm structure as it achieves the greatest reduction in agency costs**. When managers and promoters offer corporate securities, a skeptical market will bid down the price of those securities upon capital markets, and make managers bear the risk of their shirking and disloyalty unless managers offer sufficient monitoring and bonding structures to obviate this risk.
  - This view diminishes the view that corporation as hierarchy and the problems of management accountability and legitimacy. The role of corporate law and state regulation also declines since the contracting parties as rational utilitarians are entitled to structure their relations as they wish.
  - There is also the assumption that the duty of management is to maximize the wealth of their principals, the shareholder owners of the firm and that the function of corporate law is to promote that end.
    - Shareholders are ultimate risk bearers in the firm in that their financial claims as shareholders are postponed to those of creditors in the winding up of the company, their entitlement to surplus income during the firm's life and their usual monopoly of voting rights. (Shareholder Primacy)
  - Against: Seeing a corporation as no more than a vast network of implicit contracts overlooks the empirical reality of social interactions within corporation. It implies that the circumstances that any participant in the enterprise may confront at any moment are fully accounted for by reference to one or more earlier negotiated bargains he or she made. (Too simplistic)
- **Stakeholder Theories**
  - **The team production model**
    - A public corporation is a team of people who enter into a complex agreement to work together for their mutual gain. Participants including shareholders, employees and perhaps other stakeholders such as creditors enter into a 'pactum subjectionis' under which they yield control over outputs and key inputs. They do not agree to specific terms or outcomes (as in

traditional contracts), but to participation in a process of internal goal setting and dispute resolution.

- The primary job of the BoD of a public corporation is not to act as agents who ruthlessly pursue shareholder's interests at the expense of employees, creditors... rather directors are trustees for the corporation itself, mediating hierarchies whose job is to balance team member's competing interests in a fashion that makes everyone happy so productive coalition stays together.
- **Communitarian theory**
  - This theory offers the concept of multifiduciary obligation, a duty owed by corporate managers to all stakeholders in the company and not merely to shareholders.
  - This means that there are duties on shareholders to bare risk and to act reasonably to avoid injury to non-shareholder – eg. Short-term shareholder gain (takeover premiums).
  - This theory has been criticized due to the indeterminacy of its standards and as ultimately **concentrating power in management hands**.
- Modern Definition: A company is a **separate legal personality** made up of a group of people with a **common cause**. It does not have a physical manifestation but it is **accorded the same rights and obligations** as a natural person (eg. Rights to own property, deal with property, sue and be sued, perpetually exist). However, it also does not have the right to vote, freedom of political communication/religion.

#### Advantages:

- Economies of scale (pooling resources together to allow development of society).
- Accumulation of capital from global sources
- Provided a way a large company to be managed: 'Separation of ownership and control - the shareholders and the managers'
- Markets were created called the '**Stock Exchange**' where people could trade their part ownership of a company to another.
- **Floating** a company is where a company's shares are sold on the public stock exchange for the first time.
- Bubble Act – Prohibited the acting or presuming to act as a corporate body and the raising or pretending to raise transferable stocks.
  - Led to the invention of the **deed of settlement**: Secured principle corporate advantages but without the benefits of incorporations. This created the 1844 legislation, which enabled them to secure de jure corporate status by formal registration with a state official.
- Joint stock companies Act 1844 (UK) established accountability mechanisms through obligations with respect to the holding of company meetings and the audit and publication of company accounts.  
Registration and regulation Act: First corporate law.
  - Made corporation a right not a privilege.
- Limited Liability Act 1855 (UK): Persons forming a company to limit their value to the par value of the share.
  - Found that those who considered unlimited liability were given more capital due to more protection.
- Deed of settlement gave way to two constitutional documents, the memorandum of association and the articles of association.

## COMPANY ADVANTAGES

1. Perpetual existence
2. Separate legal personality
3. Ownership interest can be transferred without affecting company
4. Centralised management (Even if ownership is geographically dispersed).
5. Limited Liability

Framework in Australia:

- We recede into 1862 UK Act. In 1871 Victoria created the expedient of the no liability company form to defeat fraudulent practices arising out of the mining boom.
- Constitutional Issue:

- 1989: Third national cooperative scheme was attempted. This was struck down by HC as unconstitutional s 51 (xx) corporation power, only extended to existing corporations not corps which were yet to be established.
  - Huddart, Parker v Moorehead (1909) – reason was that company law was a matter primarily for the states.
- The Whitlam Labor government introduced the Corporations and Securities Industry Bill 1974 (Cth) to establish a national regulatory commission with responsibility for securities markets.
- 1991: Alice Springs Agreement States and Cth decided to enact uniform legislation. Corporations Law legislation enacted, each state enacted a copy of this legislation.
- 2001: Corporations Act

## THEORIES AND CONCEPTIONS OF THE CORPORATION

### Concession or Privileged Theory:

- Companies can only be formed in the public interest since the Crown acts on behalf of the public.
- The State must have the duty to supervise and manage the company.
- The managerialist model views the corporation essentially as hierarchy and senior management, at the apex of the hierarchy, as the principal subject of legal regulation.

**Contractual Theory: Nexus of contracts** between different parties; shareholders, managers and other employees, lenders, suppliers and other stakeholders.

- Contracts are not in the sense that lawyers understand but rather the economist's conception of 'relationships characterized by reciprocal relations and behavior.'
- Since it is no more than a web of contracts, the view of corporation as hierarchy disappears and with it the so-called problem of management accountability and legitimacy.
- Set of private relationships and the role of corporate law should be greatly reduced.

### Limitations:

- Contract theory conceives of the corporation as no more than a vast network of implicit contracts. This means it does not recognize the large firm as having an institutional reality:
  - Overlooks social interactions within corporations.
- Moreover, corporations are seen by realists as collective entities that have identities apart from those of the individuals who temporarily fill roles within them.

### Shareholder Approach:

- A company exists to maximise profits for its shareholders.

### Stakeholder Approach: Team production model and Communitarian theory

- A company exists to serve all stakeholders; shareholders, creditors etc.
- Directors are trustees for the corporation itself- mediating hierarchies whose job is to balance team members competing interest in a fashion that keeps everyone happy enough that the productive coalition stays together.
- **This would require shareholders to internalize the costs that pursuit of profit maximization imposes upon non-shareholders through a duty to act reasonably to avoid injury to non-shareholder constituent groups in the process of corporate decision making.**

### Limitations:

- Large amounts of power fall in the hands of management since managers are empowered to set constituency against constituency in the end.

### 1.1.2 Policy concerns

## TYPES OF COMPANIES

**A company is EITHER a proprietary or a public company**

**Proprietary company traits:**

- A proprietary company **may not have more than 50 non-employee shareholders** and is constrained in the distribution of its securities.
- Proprietary companies are **registered** (if not registered it is public)

## CORPORATIONS ACT 2001 SECTION 112

Proprietary companies	Limited by shares Unlimited with share capital
Public companies	Limited by shares Limited by guarantee Unlimited with share capital No liability company

## CLASSIFICATION ACCORDING TO LIABILITY

### Definitions:

- **Share Capital** is that amount, in money or money's worth, which members of the company agree to contribute permanently to the company in their capacity as members to fund the joint enterprise or activities.
- **'Share'** is simply a proportionate interest in the net worth of the business or undertaking of the company.
  - The power to issue shares in a company is usually vested in directors. 1. Intending member will submit to the board a form of application for a specified number of shares which, when accepted, results in a contract of allotment.
- **On a winding up, the holder of share capital are the lowest ranked claimants upon the assets of the company;** only after creditors of the company have been paid their debts in full are those who have contributed share capital entitled to have it returned to them.

### Rights attaching to shares in a company:

1. To participate in financial distributions
  - a. Entitlement to receive dividend payments that the director decide and the shareholders resolve will be paid from time to time out of current profits or profit reserves.
2. In the governance of the company
  - a. Right to receive notice of meetings of members
  - b. Right to attend, speak at and demand a poll at shareholder meetings
  - c. Right to elect and remove directors
  - d. Right to vote
    - i. Since shareholders have a monopoly of voting rights, they have the power to sell control of the company and thereby displace its management.

A company is either:

1. A **company limited by shares**
2. **Company limited by guarantee\***
3. An **unlimited company with share capital** or
4. A **no liability company**, a form available only to **mining companies\***

\*Guarantee and no-liability companies **are not allowed to be registered as proprietary companies.**

**The six types are specified in s 112(1) of CA.**

## COMPANY LIMITED BY SHARES

- Liability to any amount that is unpaid on the shares held by shareholders (s 9)
  - If shares are fully paid, **their holder has no further obligation to contribute to the debts and liabilities of the company**, at least in relation to those shares.
- **Proprietary company limited by shares** only need 1 member at least.

- **Prior to 1998**, a company limited by shares was required to include in its memorandum of association, the incorporating constitutional documents, a statement of the authorised or nominal capital with which the company was to be incorporated. (Abolished now)

#### **COMPANY LIMITED BY GUARANTEE (DEFINITELY PUBLIC – CANNOT BE REGISTERED)**

- Usually employed by non-profit activities.
- Limited to respective amount that the guarantors guarantee. (Here no shares are being issued)
  - Does NOT have share capital
- Since member's guarantee may only be enforced on the winding up of the company, they are NOT assets of the company, which may be charged during its life.
- Since 2010, companies limited by guarantee are prohibited from paying dividends to members: s 254SA.
- Guarantee companies with annual revenue of **\$1 million or more must prepare an audited financial report**
  - Those **ranging between 250,000 - \$1 million** (and those below 250,000 but with deductible gift recipients statuses under the Income Tax Assessment Act) must prepare a financial report but **may elect to have it reviewed rather than audited**.
  - **Small companies** with under \$250,000 and no deductible gift recipients **are not required to prepare a financial report unless directed to do so by members of ASIC**.

#### **COMPANIES LIMITED BY BOTH SHARES AND GUARANTEE**

- No longer exists but those incorporated prior to legislation still exist (s 1378)
- Usually exist when companies limited by guarantee require some initial capital eg to acquire a premise.

#### **UNLIMITED LIABILITY COMPANY**

- Original form of the registered company, a company whose members have no limit placed on their individual liability to contribute to the debts of the company. (s 9)
- Only when company's debts are exhausted then liability rests on the shareholders. (Not directly liable)
- Advantage: Under law of maintenance of a company's share capital, a company may only reduce its share capital pursuant to a formal approval mechanism. They can simply buy back their shares.
- It enables to obtain additional funds because the financiers are assured of refund of loan.
- Acts as a cushion against reckless business activities
- Guard against inefficiency and carelessness of partners
- Credibility of the firm in the eye of public
- Disadv:
  - Discourages partnerships and risky business initiatives.

#### **NO LIABILITY COMPANY (DEFINITELY PUBLIC – CANNOT BE REGISTERED)**

- Shareholders are not liable to pay a call on their shares while their company is a going concern.
- When company requests more capital, shareholders have a choice to give more capital or give up their share. If they give up their share they do not get any money back.

#### **Requirements to register as no-liability:**

- **Company needs to have share capital**
- **Needs to have the sole purpose of mining (extracting, selling ores, metals or minerals: s 9)**
- **Company has no contractual right under its constitution to recover calls made on its shares from a shareholder who fails to pay them (s 112(2))**
- Has NL as part of the name/end of the name (s148(4)).



## CLASSIFICATION ACCORDING TO SIZE

- Company can register as a proprietary company if it has no more than 50 shareholders and does not engage in the Corporation Act that requires it to issue a prospectus.
- **Section 45A sets out the requirements of a proprietary company and s 113 extends on the 50 non-employee shareholder rule.**
- Public company is not a proprietary company.
- Only type 1 or 3 can be a proprietary company
- Type 2 or 4 must be public companies.

### PROPRIETARY COMPANIES (EITHER TYPE 1 OR 3)

- **No more than 50 members** excluding employees of the company or its subsidiaries AND
- **Must not engage in any activity that would require the lodgement of a prospectus** or other disclosure document under Ch 6D although the company may offer its shares to existing shareholders and employees of the company or its subsidiaries (s 113)

#### Privileges of all proprietary companies:

- Can register with a **single shareholder and trade with a single director** (ss 114(1), 221(1))
- Requirement to hold an annual general meeting applies only to public companies (s 250N)
- May use the facility of passing shareholder resolutions without holding a meeting (s 249A)
- Proprietary companies stand outside the prohibition upon participation of directors in deliberations of the board of directions in relation to matters in which they have a material personal interest and upon related party transactions under Ch 2E. **(Directors can participate in decision making even with personal interest)**

All companies **must keep written financial records** that correctly record and explain their transactions and financial position to be **prepared and audited (s 286)**.

#### SMALL

To be a **small proprietary company for a financial year**, it must satisfy at least 2/3 criterion:

- Consolidate **gross income is less than \$25m**
- **Assets is less than \$12.5m**
- Total number of employees is **less than 50**.

A small company is **required to prepare financial statements and send them to members** only if:

- Shareholders with at least 5% of votes direct the company to do so (s 293)
- Company is controlled by a foreign company and is not included in consolidated accounts lodged with ASIC by the foreign company (s 292) or
- ASIC directs it to do so (s 294)

**ASIC may relieve a company from financial reporting** and audit obligations, including those **arising by virtue of shareholder direction**, by reference to criteria including whether these **obligations would impose unreasonable burdens on the company (s 342)**.

#### LARGE

- Must also prepare **financial statements** for each financial year, have those **statements audited and lodge them with ASIC** so that they are **publicly accessible (s 295)**.

## SALOMON V A SALOMON & CO PTY LTD [1897] AC 22

Principle	A company exists as a separate legal entity- separate to its members and separate to its directors. Shareholders of a company have limited liability and cannot be liable for the debts of the company.
Facts	<p>Mr Salomon ran a successful leather business as a sole trader. He set up and registered a company called A Salomon &amp; Co Pty Ltd with 20,007 shares (one to each of his sons and wife).</p> <p>Mr Salomon secured payment of the \$10,000 debt through the issue of debentures (loans) secured by a floating charge covering all assets of the company. Mr Salomon was the majority shareholder and the primary creditor was owed \$10,000 under the debenture when the company was wound up. On sale of the assets, the sum realized was less than the amount of the debentures held by Mr Salomon, and the unsecured creditors received nothing.</p> <p style="text-align: center;"><b>The liquidator on behalf of the company is suing Mr Salomon.</b></p>
Issue	<p>Should Mr Salomon's secured debt of \$10,000 take precedence over unsecured creditors who were owed approximately \$11,000?</p> <p>Generally, company law prioritises secured debt in the event of a winding up</p> <p>Unsecured creditors would get nothing if all the assets were exhausted to satisfy secured creditors.</p>
Reasoning	<ol style="list-style-type: none"> <li>1. The company was a mere agent or alter ego of Mr Salomon and thus Mr Salomon was liable for the company's debts</li> <li>2. The debentures issued to Mr Salomon were invalid on the basis of fraud</li> <li>3. The transfer of the business was said to be based on fraud; and</li> <li>4. Alternatively, the liquidator claimed \$20,000 for Mr Salomon's shares on the basis he had paid nothing for.</li> </ol> <p><b>Court of Appeal:</b></p> <ul style="list-style-type: none"> <li>• Held that Mr Salomon should pay the creditors.</li> <li>• Mr Salomon had abused the privileges of incorporation and limited liability provided by the Company's Acts</li> <li>• These should only be enjoyed by 'independent bona fide shareholders' who had a mind and will of their own and were not 'mere puppets' of the individual who carried on his business in the same way as before, when he was a sole trader.</li> </ul> <p><b>House of Lords:</b></p> <ul style="list-style-type: none"> <li>• 7 subscribers each must hold at least 1 share. Mr Salomon has complied and nothing to suggest that they need to have a mind and will of their own.</li> <li>• Therefore Mr Salomon has made a company and is regarded as a secured creditor.</li> <li>• Lord MacNaughton at 51, 'The company at law is a different person altogether from the subscribers to the memorandum; and, though it may be that after incorporation the business is precisely the same as it was before, and the same persons are managers, and the same hands receive the profits, the company is not in law the agent of the subscribers or trustees for them. Nor are the subscribers as members liable, in any shape or form, except to the extent and in the manner provided by the Act.</li> <li>• So... the fact that a company, which is <b>properly formed</b>, is totally controlled by one person doesn't establish agency.</li> </ul>

## LEE V LEE'S AIR FARMING LTD [1961] AC 12

Principle	A person can operate in a dual capacity in a company. Company is separate even from controllers.
Facts	Mr Lee established a company to carry on an aerial spraying business. Lee was the controlling shareholder, governing director and also an employee pilot of the company when he was killed in a plane crash. Lee's wife sought compensation under a worker's compensation insurance policy that the company had maintained pursuant to its statutory obligations.
Issue	<p>Mr Lee as governing director, could he also be employed?</p> <p>A 'worker was defined as someone who works under a contract of service with an employer.</p>



Reasoning	<p>CA rejected the widow's claim on the basis that because Mr Lee was the governing director, who had full control, he could not also be the company's servant.</p> <p><b>Privy Council:</b></p> <p>Mr Lee was an employee of the company, <b>which was not in any way inconsistent with his other capacities of shareholder and director</b>, and therefore Mrs Lee was entitled to compensation under the insurance policy. The court stated (at 25): 'It is a logical consequence of the decision in Salomon's case that one person may function in dual capacities.'</p> <p><i>Question to think about: What if the dual capacity was conflicting in nature?</i></p>
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