

2. Corporate Personality & Limited Liability

Corporate as a Separate Legal Entity

COMMON LAW

Golden rule

- A company exists as a separate legal entity. Accordingly, the **rights, powers and burdens** of a registered company generally rest with the company, rather than the directors or shareholders of the company: [Salomon](#).
 - No requirement that members be independent.
 - The motives of those who took part in the promotion of the company are irrelevant.
 - No requirement of substantial capital. – [Salomon](#) fostered the development of the “two-dollar company”.
 - Unfairness alone cannot justify a court departing from the separate entity doctrine.

Legal consequences

- Some of the main consequences flowing from the application of the separate identity principle: – Once a company is incorporated,
 - there is a distinction between private and company debts: [Salomon](#)
 - ~ The company, being a separate legal person, bears the liability for the debts, even though the creditor is also a shareholder.
 - there is a distinction between private and company assets: [Salomon](#)
 - ~ Assets purchased by the company or otherwise held in the company's name belong to the company, they are not owned by the directors, shareholders or other participants in the company.
 - ~ This is so even a shareholder who owns 100% of the shares and is the sole director: [Lee](#)
 - a company can contract with its members; (making it possible for **a person to act in multiple capacities**)
 - ~ The fact that the member is a controlling shareholder or a director doesn't prohibit them from contracting with the company.
 - a company can be liable in tort to a member.
 - ~ The intersection between the separate entity doctrine and employment law principle (all employers owe a duty of care to provide a safe system of work for their employees) makes it permissible for an injured employee (who is also the founder and director of the company) to sue that company for negligence.

Control & Agent

- Even where the company has only one member in a position to exercise complete control over it, control by that member will not make the company an agent of that member so as to make its acts bring rights or duties to the member: [Salomon](#).
 - Query whether there is legitimate business purpose for the incorporation.
- The difference between [Salomon's](#) case and [Smith Stone & Knight](#): – Ct prefers separate personality, but may admit agency occasionally.
 - In [Salomon's](#) case, the question was whether an **company** was an agent of the individual; while in [Smith Stone & Knight](#), the issue was whether an **subsidiary** was an agent of its parent company. – the subject of the principal is different, individual cf. company;
 - Secondly, in the context of [Salomon's](#) case, it is an **outsider** (a liquidator) who wanted to argue that company was the agent of the [Salomon](#); while in [Smith Stone & Knight](#), it was the **parent company itself** (i.e., the insider) wanted to argue that the two companies should not be treated as separate legal entities.

STATUTES

- Under s 124, a company has the **full capacity of an individual**, which allows the corporation to engage in any lawful business activity. In addition, a company also has all powers of a body corporate, including the power to:
 - (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 this jurisdiction;
 - (h) do anything that it is authorised to do by any other law (including a law of a foreign country).

2. Corporate Personality & Limited Liability

Piercing the Corporate Veil

- The “corporate veil” exists once a company is registered and it separates the company from the people who formed it (and from those who become its members). Therefore, a “corporate veil” will prevent outsiders from peeping in to see who is in charge or control of the company.
- However, in some circumstances, courts may wish to look behind the corporate veil to determine why the company was formed, or to see who is in charge or actually controlling the company. – this judicial technique is often referred to as “lifting” or “piercing” the corporate veil.
- But, generally speaking, there is no settled principle for piercing the corporate veil: [Briggs v James Hardie](#).
- Lifting the corporate veil is designed to penetrate the shield of limited liability **in special circumstances** and reach the assets of the company.
- * However, noteworthy, piercing the corporate veil should be the last resort: [Prest v Petrodel Resources](#).

Common Law

FRAUD OR IMPROPER CONDUCT

- When the notion of legal entity is used to defeat public convenience, justify wrong, protect fraud, or defend crime, the corporate veil will be pierced: [Briggs v James Hardie](#).
 - to avoid a **pre-existing legal obligation**: [Gilford Motor](#), [Jones v Lipman](#).
 - where a company was formed for an unlawful purpose: [Jones v Lipman](#).

CORPORATE GROUP

- A company would be another's **subsidiary** when: s 46, CA
 - its composition of the board is **controlled** by another company; (i)
 - another company is in a position to cast, or **control** the casting of, more than half of the votes in a GM; or (ii)
 - another company holds more than half of the share capital. (iii).- * There is no “control” if a company has the capacity to influence decisions about another company's financial and operating policy, and is under a legal obligation to exercise that capacity for the benefit of someone other than the first company itself: s 50(4).
- A corporation is a **holding company** when...the corporation owns or controls a subsidiary: s 9, CA.
- The doctrine of separate entity doctrine formally persists that each company within a corporate group remains a separate legal entity.
- Thus, in the absence of special contractual arrangements, statutory obligations or veil piercing, creditors of each company within the group are entitled to look only to the resources of that company for the discharge of their debts and obligations: [Industrial Equity v Blackburn](#).
- However, under some situations, the corporate veil may be pierced so that each company within a corporate group would not be regarded as separate legal entities (i.e., the liability and rights would be shared). Relevant considerations include: [DHN Food Distributors](#)
 - Whether those subsidiaries are wholly owned?
 - Whether the subsidiaries have no separate business operations?
 - The nature of the question involved – for example, whether there is any disturbance of the corporate group's overall business?
- But there is still a tension between the legal treatment of corporate group and the commercial realities: [Qintex](#).
 - This is because in everyday commercial life, participants in contractual transactions involving conglomerates rarely consider which of the subsidiaries should become the contracting party.
 - However, the position at law is that each company within the group normally is treated separately, based on [Salomon](#).

Agency

- Where there is an agency relationship between the two companies, the liability of the subsidiary (as an agent) **may** be attributed to its parent (as a principal): [Smith Stone & Knight](#), but this area of law remains uncertain: [Briggs v James Hardie](#).

identification of an agency relationship: [Smith Stone & Knight](#) – all these questions must be answered **affirmatively**.

- Were the **profits** of the business treated as profits of the parent? (and perhaps no asset: [Ramsey Food](#))
- Did the parent **appoint** the persons carrying on the business?
- Was the parent the **head and brain** of the trading venture?
- Did the parent **govern** the adventure, decide what should be done and determine what capital should be embarked on the venture?
- Did the parent make the profits by its skill and direction?
- Was the parent in **effectual and constant control**?
 - Arguably, undercapitalisation may be a reason to find an agency (subsidiary is exclusively financed by the holding company): [Re FG](#);
~ In [Briggs v James Hardie](#), it was held this point of view is arguable, but not sure how far it works in Australia.
- * It was held in [Briggs v James Hardie](#) that the mere control, even **overwhelming control of a company** is not sufficient to constitute a basis for veil-piercing, need to look whether there is other possible mechanism to support the veil-piercing.
 - Whether the specific company within the corporate group has **sufficient capital or insurance to cover foreseeable risks**;
 - **High level of control** by a parent might in some cases enable a plaintiff to establish an action in tort against the parent on the basis that it **breached a duty of care** owed directly to the plaintiff: [CSR v Wren](#);
 - Vicarious parent company liability for acts of an employee appointed as a nominee director to the board of a subsidiary: [Dairy Container v LTD v NZI Bank Ltd](#); – New Zealand case, unsure whether it applies to Australia or not.
 - **Shadow directors**: [Standard Chartered Bank of Australia Ltd v Antico](#).
 - The nature of the claim – for example: **contractual claim** (no piercing) vs. **tortious claim** (piercing may be available).
~ In a contractual claim, the victim has the right to choose the contracting party, but not in a tortious claim.
 - Claims related to **employee's entitlements** from the insolvent subsidiary: [Ramsey Food Processing](#), see statutory obligation below.

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CORPORATE GROUP - AGENCY (Continued)

Shadow director

- “**Shadow director**” is a person who, although not formerly appointed as a director, is able to exert significant influence over the decisions made by the board of directors: s 9.
 - The key issue is whether the officially appointed board of directors is “**accustomed to act in accordance with the person’s instructions or wishes**”.
- Although under s 201B of the CA, companies cannot be appointed as a director, s 9(b)(ii) extends the definition of “director” to “shadow director” which is likely to extend to companies.
- * Once a person is regarded as de facto / shadow director, all the obligations imposed on a director are fit for him.

- Firstly, the mere fact that a holding company owned a huge percentage of the shares of the subsidiary, and had some nominees on the subsidiary’s board, is insufficient: [Standard Chartered Bank of Australia v Antico](#).
- Moreover, a person is not a shadow director merely because they impose conditions on their commercial dealings with a company, even if the company feels that it has no choice but to comply with those conditions: [Buzzle Operation v Apple](#).
 - * The test is whether the directors of the company are free (and expected) to exercise independent judgment as to whether it is in the company’s interests to comply with the proposed conditions.
- Important factors relevant in determining whether there is a shadow director: [Buzzle Operation v Apple](#).
 - The vital factor is that the shadow director has the **potentiality to control**. This can be indicated from, (e.g., [Standard Chartered](#))
 - ~ effective control of the board of the company, for example, being the most significant shareholder;
 - ~ an additional financial report being requested by the shadow director;
 - ~ important decisions are effectively made by the shadow director, and the company simply accepts the decision without further considerations;
 - ~ the nominees of the shadow director make their decision under the instruction of the board of the shadow director company.
 - There must be a **causal connection** between the instructions or wish of the shadow director and the act taken by the company.
 - **Habitual compliance**: the shadow director must exercise influence **over a majority** of directors over a period of time.
 - **Instructions to directors in directorial capacity**: the instructions must be expressed to the persons in their capacity as directors, not those board members in a different capacity (for example, shareholders or employees of the company)
 - Whether the alleged shadow director has a genuine interest of his own in giving advice to the board, such as a **creditor**.

De facto director

- “**De facto director**” occurs where a person acts in the position of a director without proper authority: s 9. – for example:
 - the director has not been validly appointed initially since he failed to satisfy a prerequisite;
 - the director no longer validly holds the office as a result of supervening disqualification;
 - the director has resigned as a director, but has not notified the ASIC: [Deputy Commissioner of Taxation v Austin](#).
 - the director has assumed greater authority than that has been attached to his office.
- The significance of being treated as a director is that the fiduciary duties at general law and the statutory duties imposed on directors by Pt 2D.1 and s 588G will apply, despite the defect in appointment.
- Further, although under s 201B of the CA, companies cannot be appointed as a director s 9(b)(ii) extends the definition of “director” to “de facto director” which is likely to extend to companies.
- A rigid distinction between a de facto and a shadow director cannot be maintained: [Grimaldi v Chameleon Mining](#).
- A de facto director is one “who acts in the position [of director], with or without lawful authority: [CAC v Drysdale](#). – question of fact.
- The fact that a company has a properly constituted and apparently “functioning” board...does not...preclude the making of a finding that the person in question could be a “director”: [Grimaldi v Chameleon Mining](#).
- The test is whether a person performs functions that can only be performed by a de jure director with the acquiescence of the board: [Grimaldi v Chameleon Mining](#). – practical direction and effective control can be found through:
 - attending board meeting: [CAC v Drysdale](#).
 - voting on resolution with the other director: [CAC v Drysdale](#).
 - participating generally in the management of the company: [CAC v Drysdale](#).
 - negotiating taxation related issue on behalf of the company with DCT: [DCT v Austin](#).
 - countersigning company cheques: [DCT v Austin](#).
 - negotiating with other creditors: [DCT v Austin](#).
 - issuing stop notice to the company’s bank: [DCT v Austin](#).

Statute Obligations

HOLDING COMPANY’S LIABILITY

- s 588V lifts the corporate veil by making the holding company liable for the debts of its subsidiary where there are reasonable grounds for suspecting that the subsidiary is insolvent at the time of incurring that debt.
- A company contravening s 588V can be subjected to a civil penalty order.

HOLDING COMPANY'S LIABILITY (Continued)

Definition

- A company would be another's **subsidiary** when: s 46, CA
 - its composition of the board is **controlled** by another company; (i)
 - another company is in a position to cast, or **control** the casting of, more than half of the votes in a GM; or (ii)
 - another company holds more than half of the share capital. (iii).
- * There is no "control" if a company has the capacity to influence decisions about another company's financial and operating policy, and is under a legal obligation to exercise that capacity for the benefit of someone other than the first company itself: s 50(4).
- A corporation is a **holding company** when...the corporation owns or controls a subsidiary: s 9, CA – i.e., holding company on the top.
- A person is solvent if the person is able to pay all the person's debts, as and when they become due and payable: s 95A(1).
 - A person who is not solvent is **insolvent**: s 95A(2).

Elements of s 588V

- The corporation was the holding company of a company at the time when the company incurred a debt: (1)(a);
- The company was insolvent at that time, or became insolvent by incurring that debt: (1)(b);
- At the time of the subsidiary incurring the debt, there was, on an objective basis, reasonable grounds for suspecting insolvency: (1)(c); and
- In addition, it must be shown: (1)(d)
 - that the holding company, or one or more of its directors, was aware of reasonable grounds for suspecting insolvency; or
 - having regard to the nature and extent of the corporation's control over the company's affairs and to any other relevant circumstances, it is reasonable to expect awareness by the holding company or awareness by one or more of its directors.

DIRECTOR'S PERSONAL LIABILITY FOR INSOLVENT TRADING

- s 588G imposes personal liability on directors who allow a company to incur debts while insolvent.
 - Accordingly, the liquidator, or creditor with prior consent, can sue the company director for payment of the company's debts incurred when the company is unable to pay its debts as and when they become due and payable.
- "Director" is not limited to a person who is appointed to the position of a director or the position of an alternate director, but also extends to a shadow director and a de facto director: s 9.

Elements for s 588G s 588(1)

- a person is a director of a company;
 - at the time when the company incurs a debt;
 - the company is insolvent at that time, or becomes insolvent by incurring that debt, or by incurring at that time debt including that debt;
 - at that time, there are reasonable grounds for suspecting that the company is insolvent, or would so become insolvent.
- * Note, the section only apply to debts are incurred after 23 June 1993.

Civil Penalty: s 588(2) – the conditions in subs(1) are satisfied.

- If the director fails to prevent the company from incurring the debt and
 - either the director is aware of the existence of the reasonable grounds for suspecting insolvency (at that time),
 - or a reasonable person in a like position in the company in the company's circumstances would be aware.
- ✓ The director incurs a civil liability.

Criminal Offence: s 588(3) – the first two conditions in subs(1) are satisfied.

- If the director suspected at the time when the company incurred the debt that it was insolvent or would become insolvent as a result of incurring the debt or other debts; and
 - the director's failure to prevent the company incurring the debt was **dishonest**;
- ✓ The director contravenes a criminal offence.

EMPLOYEE ENTITLEMENTS

- Part 5.8A (for our purpose, principal provisions from ss 596AA-AC) is designed to protect the entitlements of a company's employee from agreements and transactions that are entered into with the intention of defeating the recovery of those entitlements: s 596AA(1).
- These **entitlements** include wages, superannuation contributions, amounts due in respect of injury compensation in relation to the employee, amounts due in respect of the employee's leave of absence and retrenchment payments for the employee (payment in respect of the termination of the employee's employment): s 596AA(2).
- By s 596AB(1), a person must not enter into a relevant agreement or a transaction with the intention of:
 - preventing the recovery of the entitlements of employees of a company; and
 - significantly reducing the amount of the entitlements of employees of a company that can be recovered.
- Under s 596AC(1), a person is personally liable to pay the compensation where s 596AB(1) is satisfied, and if
 - the company is being wound up; and
 - the employees suffer loss or damage because of the contravention.
- Either the company's liquidator (s 596AC(2)) or the employee himself (s 596AC(3)) may seek the recovery.
- Limitation period is 6 years after the beginning of the winding up: s 596AC(4).