

# TOPIC 1: INTRODUCTION TO CORPORATE LAW

## WHAT IS LAW?

- There are two primary sources of law in Australia:
  - **Statute / Legislation / Acts** – law made by parliament
  - **Case law / Precedent / Common law** – law made by the courts

## WHAT IS COMPANY LAW?

- **Company law** – general used to describe the legal rules which govern...
  - Formation and termination of companies
  - Characteristics of companies
  - Relationships between participants in companies – directors, officers, shareholders, creditors
  - Companies' dealing with outsiders
- Company law's aims and purposes include:
  - Investor protection
  - Commercial stability and consumer confidence
  - Certainty
    - Standard form rules

## WHAT IS A COMPANY?

- A company...
  - Is a person
  - Can sue and be sued
  - Can enter into contracts
  - Can raise funds
  - Stays operational due to its directors and members (shareholders)
    - Shareholders have limited rights
- **Perpetual succession** – a company's existence can continue even after the death of the owner, bankruptcy or change in membership... etc.
- **Doctrine of separate legal entity** – a company is a separate legal entity to its owners
  - Companies can legally do most things that humans can do (own land, sign contracts, sue, enter into relationships) and **more** (issue shares)
  - Company is a separate tax payer
  - When a company is sued, the company as an entity must pay (not its shareholders)
- Salomon v Salomon
  - Salomon was the owner of a shoe-making business and operated a sole proprietor
  - Salomon decided to set up a new company and sell his business to the company
    - In exchange for the sale of the shoe business, the company paid Salomon (issued shares) and gave him security over on its assets in the form of a debenture

- The debenture gave him secured right and priority over other creditors meaning that the company's assets must be paid to Salomon first if the business liquidated
  - When the company went bust, there were insufficient assets to pay out all the creditors and they argued that there was no distinction between Salomon (the individual) and Salomon (the company)
  - **Issue:** was Mr Salmon entitled to priority under the debenture over other unsecured creditors of the company?
    - Court held that the company was a separate legal entity to Salomon and allowed him to obtain priority payment
    - **Doctrine of separate legal entity**
- Lee v Lee's Air Farming Ltd
  - Lee was the governing director of his business which undertook aerial spraying of crops
  - Whilst flying on the job, Lee was killed and his wife attempted to claim 'workers compensation' under the reasoning that Lee was an employee of the company and died whilst conducting its business
    - The insurance company argued that the company and Mr Lee were the same entity so it would be impossible for Lee to enter into an employee contract with the company owned and operated by him
  - **Issue:** could Mr Lee be both the controller of a company and its employee?
    - Court held that the company was a separate legal entity from Lee and it was possible to enter into an employment contract with the company
    - **Doctrine of separate legal entity**
- Macaura v Northern Assurance
  - Macaura owned a timber plantation and transferred the ownership of the plantation into the name of a company owned and operated by him
    - Macaura did not transfer the insurance policy meaning that the company owned the asset but Macaura had the insurance
  - When the timber plantation died, Macaura attempted to make a claim for damages but the insurance company refused to pay because the company itself didn't have insurable interest
  - **Issue:** was Mr Macaura the "owner" of property that belonged to a company controlled by him?
    - Court held that the timber plantation belonged to the company (a separate legal entity) so Macaura couldn't claim the insurance damages
    - **Doctrine of separate legal entity**

#### **PRIVATE AND PUBLIC LAW**

- **Private law (civil law)** – decides disputes between shareholders and the company
- **Public law** – allows ASIC to punish wrongdoers and seek compensation for the company
  - ASIC applies for penalties and can seek criminal action against officers, directors of the company

## EQUITY CAPITAL

- **s124 CA**
  - (1) 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:
    - (a) Issue and cancel shares in a company
- **Shares** – claims against a company to which ‘rights’ are attached
  - Shares are valuable assets that are pieces of personal property belonging to the shareholder (represents ownership in the company)
    - Can be sold, mortgaged, devised by will by the shareholder in the same way as other property
  - Shareholders can exercise these rights against the company
  - Companies can be shareholders in companies which entitles them to shareholder rights and remedies
- Different classes of shares have different rights (as decided by the company – **s254B**)
  - Dividends rights
  - Voting rights
  - Rights and priorities in repayment of capital or surplus on winding up
- Directors have the power to issue shares (**s198A**) but the issue of shares may require shareholder approval in some circumstances
- **Ordinary shares**
  - Right to share equally in dividends
  - Right to vote at the general meeting of the company
- **Preference shares** (approved by shareholders – **s254A(2) CA**)
  - Right to fixed dividend (provided there are profits)
  - Priority for repayment of capital
  - Limited voting rights
  - No right to share surplus on winding up

## DEBT FINANCE

- **Debt** – money that company owes to outsiders
  - Can be **secured** against assets (collateral) or **unsecured**
  - Debt must be repaid regardless of whether the company is profitable
  - Debt attracts interest

## DEBT V EQUITY

- Financing method depends on the company’s needs and objectives
  - Equity financing appears to be safer since you don’t need to actually pay out a dividend
    - But issuing shares means handing out voting rights and control of the company
  - Debt financing has to be repaid

### LIMITED LIABILITY

- The company's debts have to be paid by the company, not its shareholders
- In a company limited by shares, a member's liability to pay debts of the company is limited to the amount **unpaid** on their shares (**s516**)
  - If shares are **fully paid for**, not further contribution is required
  - Creditors can only come to shareholders for amounts that are **unpaid** on their shares, the rest of their liability is protected
- A company may issue shares that are partly paid
  - Shareholder is obliged to contribute further if a **call** is made on partly paid shares
    - If call is not paid, shares may be forfeited
  - **s254M CA**

## TOPIC 2: BUSINESS PLANNING & CONSTITUTING COMPANIES

### FORMS OF BUSINESS

- **Unincorporated entities** – have no legal personality separate from their participants
  - Sole traders – creditors can sue owner personally
  - Partnerships – collection of sole traders working together
    - If a partnership can't pay off its debts, then the partners become personally liable
- **Incorporated entities** – separate legal persons
  - Associations can be incorporated under state laws
  - BLAW20001 focuses on companies incorporated under ***Corporations Act 2001 (Cth)***
- **Relevant considerations:**
  - Will you make a profit or is it a non-profit?
  - Do you want limited or unlimited liability for shareholders?
    - Some professions don't allow you to conduct your business through limited companies
    - Partnerships reflect unlimited liability of each partner
  - How big do you want your business to be?
    - There are limits on the size of partnerships and unincorporated entities
  - Do you need to raise equity capital?
    - Partnerships cannot raise equity capital beyond partners
    - Need public company to issue shares to the public
  - Are you willing to comply with formalities and pay expenses?
    - Forms need to be submitted and fees paid to ASIC
  - Are you willing to submit your business to audit and reporting requirements?
    - Partnerships and sole traders don't need to be audited
  - Do you want a particular tax treatment?
    - Tax treatment – split income amongst shareholders
    - Partnerships and sole traders have marginal tax rate
- **Advantages of establishing a company:**
  - Can have more than 20 members
    - Outsize partnerships prohibited by **s115**
  - May have limited liability
  - May be easier to raise capital
  - Different tax treatment
    - Dividend imputation
    - Flat tax rate
  - Company law as standard form contract
    - Everybody knows where they stand at all times
  - Flexibility
- **Disadvantages of establishing a company:**
  - Usually greater expense in formation and compliance
  - May have to reveal information to the public

## **TYPES OF COMPANIES**

- Corporations formed under the **Corporations Act** are “companies”

### **SECTION 112 TYPES OF COMPANIES**

**112(1) Types of companies.** The following types of companies can be registered under this Act:

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

- Companies are classified:
  - As public (Ltd) or proprietary (Pty Ltd)
  - By reference to the basis and extent of the members' liability
    - Company limited by shares
      - ❖ As per **s516**
      - ❖ Liability of shareholders is limited to the amount that is unpaid on their shares
    - Company limited by guarantee (public companies only)
      - ❖ For example, a tennis club that doesn't want share capital but raises money from fees and memberships
      - ❖ It doesn't trade in a traditional sense but exists for the benefit of its members
      - ❖ This sort of company is set up by people signing a guarantee (for a token amount of money)
      - ❖ Every subscriber to the guarantee promises that if the company enters into liquidation, they will contribute a certain amount
    - Unlimited company
      - ❖ Not permitted to limit their liability as per profession's indemnity rules (lawyers, accountants)
      - ❖ However, they want separate legal entity (to be responsible for the lease of their offices and to enter into contracts)
      - ❖ No letters after company name
    - No liability company (public companies only)
      - ❖ Usually always mining companies
      - ❖ Exist to recognise the extreme risk that is involved in mining
      - ❖ Shares are almost always partly paid so shareholders are only liable for the \$1 they contributed and not the remaining \$9 on their shares
- **Proprietary companies:**
  - **s113**
    - Have no more than 50 non-employee members
    - Cannot undertake fundraising activities with require a disclosure document under Chapter 6D
      - ❖ Cannot issue shares to strangers which don't have a connection to the business
    - Must have one or more directors (**s201A**)

- May be a company limited by shares or an unlimited company with share capital (**s112**)
- Some different rules for proprietary companies under the **Act** or the company's internal governance rules
  - e.g. the removal of directors
- Have more flexibility and privacy
  - No need to disclose massive amounts of information to the public
- **Public companies:**
  - Everything other than proprietary companies (**s112**)
  - Must have a minimum of three directors (**s201A(2)**)
  - Sometimes have different rules
    - e.g. dividends (**s254W**)
    - e.g. disclosure
  - Are allowed to have an unlimited number of shareholders
  - Can raise funds from the public
  - Are subject to stricter rules
  - Have more procedures
    - e.g. compulsory AGMs
  - More publicity
    - e.g. published financial statements
    - Greater shareholder protection through transparency and accountability
- Companies can be shareholders in other companies
  - Often different aspects of the business are owned or carried out by different companies in a group
- **Subsidiary (s46)** – company controlled by a holding company
  - If and only if holding company controls the composition of the subsidiary's board **OR**
  - Can cast and control half the maximum number of votes that can be cast at a general meeting **OR**
  - Holds more than half of the issued share capital
  - *Does the holding company have the legal right to control the votes on the subsidiary such that it can control the appointment of directors to the subsidiary's board?*
- **s50AA – Control**
  - *(1) For the purposes of this Act, 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 and operating policies*
  - The concept of “controlled entities” is much wider than that of subsidiaries
    - It could be controlled by another company without being a subsidiary
    - All subsidiaries are entities controlled by their holding or parent company
- Registration of companies:
  - Companies are created through registration by ASIC (ASIC FORM 201)
  - **s117 – procedure**
  - ASIC FORM 201
  - **s148 – names**

- Public companies – Ltd
- Proprietary companies – Pty Ltd
- No liability – NL
- Naming tags act as a **flag** if you do business with a company

## INTERNAL GOVERNANCE OF COMPANY

- **Internal governance rules** – a set of rules decided by the company on how to manage their internal workings
  - Not enforceable in a public way (ASIC is not interested)
    - Not a breach of the **Act** if someone breaches internal governance rule
  - Regulates relationships between the participants in a company
    - Removal, appointment and power of officers
    - Procedures for convening and conducting director meetings
    - Procedures for convening and conducting member meetings
    - Rules relating to dividends
- Internal governance rules consist of:
  - Replaceable rules (from **Corporations Act s134**)
  - Company's own constitution
  - A combination of replaceable rules and the company's own constitution
- **Replaceable rules** – default set of rules from the **Corporations Act** which apply if the company doesn't establish its own
  - Set out the minimum requirements for the operation of a company
  - Replaceable rules apply unless they are displaced or modified by a constitution (**s135(2)**)
  - **s141** has a table of all the replaceable rules which are usually scattered throughout the **Act**

| Provisions that apply as replaceable rules |  |         |
|--|--|---------|
| <b>Officers and Employees</b>              |  |         |
| 1  | Voting and completion of transactions — directors of proprietary companies | 194     |
| 2  | Powers of directors  | 198A    |
| 3  | Negotiable instruments   | 198B    |
| 4  | Managing director  | 198C    |
| 5  | Company may appoint a director   | 201G    |
| 6  | Directors may appoint other directors                                      | 201H    |
| 7  | Appointment of managing directors  | 201J    |
| 8  | Alternate directors  | 201K    |
| 9  | Remuneration of directors  | 202A    |
| 10   | Director may resign by giving written notice to company                    | 203A    |
| 11   | Removal by members — proprietary company                                   | 203C    |
| 12   | Termination of appointment of managing director                            | 203F    |
| 13   | Terms and conditions of office for secretaries                             | 204F    |
| <b>Inspection of books</b>                 |  |         |
| 14   | Company or directors may allow member to inspect books                     | 247D    |
| <b>Directors' meetings</b>                 |  |         |
| 15   | Circulating resolutions of companies with more than one director           | 248A    |
| 16   | Calling directors' meetings  | 248C    |
| 17   | Chairing directors' meetings   | 248E    |
| 18   | Quorum at directors' meetings  | 248F    |
| 19   | Passing of directors' resolutions  | 248G    |
| <b>Meetings of members</b>                 |  |         |
| 20   | Calling of meetings of members by a director                               | 249C    |
| 21   | Notice to joint members  | 249J(2) |
| 22   | When notice by post or fax is given  | 249J(4) |
| 22A  | When notice under paragraph 249J(3)(cb) is given                           | 249J(5) |
| 23   | Notice of adjourned meetings   | 249M    |

| Provisions that apply as replaceable rules        |  |         |
|---|--|---------|
| 24  | Quorum   | 249T    |
| 25  | Chairing meetings of members   | 249U    |
| 26  | Business at adjourned meetings   | 249W(2) |
| 27  | Who can appoint a proxy  | 249X    |
| [replaceable rule for proprietary companies only] |  |         |
| 28  | Proxy vote valid even if member dies, revokes appointment, etc                                       | 250C(2) |
| 29  | How many votes a member has  | 250E    |
| 30  | Jointly held shares  | 250F    |
| 31  | Objections to right to vote  | 250G    |
| 32  | How voting is carried out  | 250J    |
| 33  | When and how polls must be taken   | 250M    |
| <b>Shares</b>                                     |  |         |
| 33A   | Pre-emption for existing shareholders on issue of shares in proprietary company                      | 254D    |
| 33B   | Other provisions about paying dividends  | 254U    |
| 34  | Dividend rights for shares in proprietary companies  | 254W(2) |
| <b>Transfer of Shares</b>                         |  |         |
| 35  | Transmission of shares on death  | 1072A   |
| 36  | Transmission of shares on bankruptcy   | 1072B   |
| 37  | Transmission of shares on mental incapacity  | 1072D   |
| 38  | Registration of transfers  | 1072F   |
| 39  | Additional general discretion for directors of proprietary companies to refuse to register transfers | 1072G   |