

Corporate Law Exam Notes

Ordinary claim skeleton

To weave in authority (case and legislation):

- ___ is authority for the proposition that ___. In these circumstances therefore _____.
- _____ is authority that there is justification for a _____.
- - 'the application of s__ will result in _____'

When using case law, consider:

- Does the case apply? Are the facts sufficiently similar or can it be distinguished?
- What is the ratio of the case? Is it binding precedent or just persuasive?
- Why is the current scenario similar to justify applying the case?

If missing facts, ensure to state that! State what facts would be required for a more robust analysis.

1. Ensure you understand who you are advising – whether it be a person, the company or ASIC. This will make a difference as to your answer.
2. If advising a person, are they a member of the company? – see s 231 CA.
 - a. Is the person's name entered on the register of members? – s 231(b) CA.
 - b. *Note*, the powers of members and the rights of members and the voting procedures for members – see notes below.
3. **Is there a membership/shares issue on the facts?**
 - a. Is the company attempting to reduce share capital? Per s 156B does it:
 - i. Materially prejudice creditors?
 - ii. Is it fair and reasonable to shareholders?
 - iii. Has it been approved by shareholders?
 - b. Is the company issuing shares? *NOTE: this links with directors' duties (s 181).*
 - i. A company can issue fully-paid or partly-paid shares: s 254A(1)(c). These may be on any terms, include any rights, or restrictions as determined by the company: s 254B.
 1. Preference shares must carry rights over and above at least one other class: *Re Capel Finance*
 2. But, there is no need for the other class to be issued yet: *Beck*
 3. *For details on the possible rights attached, see below!*
 - ii. Can be for cash, or non-cash consideration - see below for more details
 - c. *Is the company attempting to alter the class rights of shares?
 - i. Class rights are rights attached to shares in a class of shares: s 246B.
 - ii. ASK:
 1. Does the company have the right to issue shares – above
 2. Do certain rights attach to the shares?
 3. When are class rights varied?
 - a. Is it a deemed variation under s 246C? If not,
 - b. Does it fulfil the common law test from *Greenhalgh*?

4. Has the company undertaken the s 246B(2) process (if no process in Constitution)? - *see below*
 5. Can the member challenge the variation under s 246D? – *below*.
- d. Is the company planning to pay a dividend?
- i. Directors may determine that a dividend is payable, and fix the time, amount, and method of payment: RR s 254U(1) CA
 - ii. A dividend can be ‘declared’ or merely ‘determined’.
 1. Debt is incurred when dividend is declared (s 254V(2)). If ‘determined’ it is incurred when the time of payment arrives (s 254V(1)). – *has impacts on insolvent trading!*
 - iii. *May lead to a Members’ Oppression Remedy!*
4. **Is there an issue in relation to financial reporting obligations?**
- a. Every company must keep written financial records that, per s 286(1), correctly record and explain transactions and financial performance, which would enable a true and fair view of the company.
 - b. If it is proved that a company has failed to keep or retain financial records then the company is presumed insolvent throughout the period of its failure: s 588E(4).
 - i. *Has impacts on proving insolvency for insolvent trading provisions.*
 - c. Has the company satisfied their ‘continuous disclosure’ obligations?: ss 674-678
 - i. Is the company a disclosing entity?
 - ii. Under s 674: The company must immediately disclose all information to the ASX that a ‘reasonable person would expect to have a material effect on the price or value of the entity’s securities’.
 - iii. Is the obligation discharged due to the operation of Listing Rule 3.1A? – *see below*.
5. **Is a shareholders’ meeting being held?**
- a. Meetings must be held for proper purpose: CA s249Q
 - b. Meetings must be held at a reasonable time and place: CA s249R
 - c. Who called the meeting?
 - i. Court has the power to call a meeting: CA s249G
 - ii. Any director can call a meeting: s 249C.
 - iii. Directors must call a meeting within 21 days, at the request of shareholders holding at least 5% of the voting shares or, at least 100 members who are entitled to vote: CA s249D(1).
 - iv. If directors fail the above then shareholders holding more than 50% of the votes of all shareholders who made the request may call: CA s249E(1)
 1. If so, the company must cover all reasonable expenses incurred by the shareholders in calling the meeting: s 249E(4) CA
 2. A director is not liable if it can show it took reasonable steps to comply with above: s 249E(5)
 - v. Shareholders with at least 5% of voting shares can call (without requesting directors to do so) BUT the cost is theirs! CA s249F
 - d. Notice of at least 21 days must be given for a meeting of company shareholders: s 249H – *see below*.
 - i. Did this notice contain the s 249L content? – *see below*

- e. Ensure the quorum at the meeting was met. The quorum is two, and they must be present at all times during the meeting: s 249T(1).
- f. Voting:
 - i. A show of hands, per a replaceable rule, entitles shareholders to have one vote per person: s 250E(1) (*if a company with share capital*)
 - ii. A poll entitles shareholder to have one vote per share: s 250E(1)
 - 1. Polls can be demanded by at least 5 shareholders entitled to vote, shareholders with 5% or the chair - CA s250L(1)
- g. Any breaches of the above rules? i.e. any irregularities?
 - i. Section 1322 allows for an individual to apply to the court to have the meeting invalidated. The court will consider:
 - 1. If the irregularity was procedural and,
 - 2. Whether it has or will cause a substantial injustice.
 - ii. BUT, an individual can also apply to the court to have the meeting validated under s 1322(6) if:
 - 1. It is only a procedural irregularity
 - 2. The person involved was acting honestly
 - 3. It is just and equitable to give the order

6. Are there any breaches of ethics on the facts?

- a. Establish who the client is
- b. State the hierarchy of obligations – *the client is number 3*
- c. Note the Australian Solicitors' Conduct Rules (2011)(ASCR), the *Professional Conduct and Practice Rules* and the Barristers' Rule 6.6
- d. Ensure the advice does not breach the *Legal Practitioners Act 1981* (SA) ss 68 and 69.
 - i. Is there a person involved in a contravention under s 71 CA?
- e. *Apply case analogies!*

7. Has there been a breach of Directors' Duties? – ensure you apply to the facts to determine if the person actually breached these duties!

- a. Does the duty apply to the person, or the Board?
 - i. Are they a director, *de facto* director, or shadow director under s 9 CA?
 - 1. Note the position they may hold and their usual role.
 - ii. Are they an officer of the company under s 9 CA?
 - iii. Is the person a company secretary?
 - iv. Is there a person involved in a breach under s 79?
 - v. *Apply case analogies!*
- b. Did the person breach the common law (fiduciary) duty of loyalty?
 - i. State: s 185 and s 193 specifically preserve the common law duties.
 - ii. State: The fiduciary relationship between directors and their company is an established fiduciary category: *Regal (Hastings)* [1967] 2 AC 134.
 - iii. Fiduciary duty:
 - 1. Conflict rule: A director must not allow a 'real or substantial possibility of' conflict to arise between their interest and duties, and the duties to the company: *Hospital Products* – see below

2. Profit rule: A director not use their position to gain a profit or advantage for themselves: *Hospital Products* – see below
3. Defences: Fully informed consent? See *Furs* and *Hudson* – below
- iv. Equitable duty of good faith:
 1. ‘directors must exercise their discretion bona fide in what they consider to be in the interests of the company, and not for any collateral purpose’: *Re Smith and Fawcett* – see below
- v. *Argue case analogies!*
- c. Has there been a breach of a statutory duty of loyalty?
 - i. Section 181: A director or other officer of a corporation must exercise their powers and discharge their duties: (a) in good faith in the best interests of the corporation; AND (b) for a proper purpose. – See below!
 - ii. Section 182: A director, secretary, officer or employee must not improperly use their position to gain an advantage for themselves or another or cause detriment to the company. – See below!
 - iii. Section 183: A person who obtains information because they are (or have been) a director, officer or employee must not improperly use the information to gain an advantage for themselves or another or cause detriment to the corporation. – See below!
 - iv. Section 191-196: Has the director given notice to the other directors of any material personal interests relating to company affairs? – see below
 1. Note effects of s 195 on public companies
 2. Note effects of s 194 on proprietary companies
 - v. Chapter 2E: Is there a related party transaction on the facts? See below for the 5 step process.
- d. Has there been a breach of the statutory and common law duties of care and diligence?
 - i. State: s 180(1), and the common law equivalent, impose a positive duty on the directors/officers of companies to exercise their powers and discharge their duties with the degree of care and diligence that a reasonable person would exercise if there were a director or officer of a corporation in the corporation’s circumstances and occupied the office held by the relevant director/officer. – see below for applying it to the facts
 - ii. All directors have basic, non-reducible skills – but the duty can go up!
 1. See *AWA v Daniels* and *Daniels v Anderson*
 2. *Citrofresh* and *Healy* are authority that honesty will not prevent a breach of this duty of care.
 - iii. *Apply case analogies!*
 - iv. Defences:
 1. Can the director/officer rely on the s 189 defence? See *Daniels* and ss 198D and 190
 2. Can the business judgement rule be applied? Per s 180(2) if:
 - a. Made the business judgement in good faith for a proper purpose,

- b. Did not have a material personal interest in the subject matter,
 - c. Informed themselves about the subject matter of the judgement to the extent they reasonably believed to be appropriate, and
 - d. Rationally believed that the judgement was in the best interests of the corporation.
 - 3. *Apply case analogies!*
- e. Has there been a breach of the duty to avoid insolvent trading under s 588G?
 - i. State: section 588G is authority that a director is under a duty to prevent the company incurring debts if there are reasonable grounds for suspecting that it is insolvent.
 - ii. Determine if the duty applies to the defendant using the criteria under s 588G – *see below*
 - iii. Determine if the duty was breached under s 588G(2) – *see below*.
 - iv. Are there any defences? – *See below for more information!*
 - 1. Reasonable grounds to expect solvency at the time the debt was incurred (and would remain solvent when debt was incurred): *Metropolitan Fire Systems v Miller* (1997) 23 ACSR 699 and s 588H(2)
 - 2. Reasonable reliance on information as to solvency provided by others: *Re McLellan; Stakeman Pty Ltd v Carroll* [2009] FCA 1415 and s 588H(3)
 - 3. Non-participation in management due to illness or another good reason: *DCT v Clark* [2003] NSWCA 91 and s 588H(4)
 - 4. Reasonable steps taken to prevent incurring of debt: s 588H(5)
 - 5. Per s 1317S(2), the court may relieve a person, either wholly or partly, from a liability for a contravention of s 588G, if it appears that the person has acted honestly and having regard to all circumstances, ought fairly to be excused.
 - v. *Apply case analogies!*
- f. What remedy is available and appropriate?
 - i. *Note the proper plaintiff rule.*
 - ii. The plaintiff could seek for a breach of the common law duties:
 - 1. Equitable compensation – *see below!*
 - 2. An equitable account of profits – *see below!*
 - 3. An equitable rescission of contract – *see below!*
 - 4. An equitable constructive trust – *see below!*
 - 5. An equitable injunction – *see below!*
 - iii. The plaintiff could seek for a breach of the statutory duties:
 - 1. Compensation under s 1317J(2) if they are the corporation.
 - 2. If ASIC, and they gain a DoC, a:
 - a. Pecuniary penalty order under s 1317G
 - b. Order disqualifying the directors under s 206C
 - c. Injunction to restrain breaches under s 1324
 - d. Compensation to the company under s 1317H

3. If the director has been dishonest within their breach, under s 184, they could be subject to a criminal penalty. – *See below!*
 - iv. Any arguments for relief from liability?
 1. From the courts under s 1317 (or 1318 if common law breach), if the person was acting honestly and, having regard to the circumstances, ought to be excused. – *see below!*
 2. From the company (directors or shareholders): through ratification – *see below!*
 3. *See below for other smaller arguments.*
- 8. Are members' remedies being sought?**
- a. Note the rule of *Foss v Harbottle*, that the company is the proper plaintiff and that the courts should not interfere with the company's internal management.
 - i. But, there are exceptions to this: - *see below!*
 1. Personal actions where irregularity could not be condoned by general meeting
 2. Fraud on the minority
 3. Where the majority are attempting to alter the constitution to remove property rights: *Gambotto*
 4. Where the Members' personal rights are being breached
 5. Where there is a breach of statutory contract
 - b. Will the plaintiff seek an oppression remedy under part 2F.1?
 - i. Does the person have standing under s 234? - *See below!*
 - ii. Does the person have grounds for the action under s 232? - *See below!*
 - iii. What are the remedies sought under s 233? - *See below!*
 - iv. *Apply case analogies!*
 - c. Will the plaintiff bring a Statutory Derivative Action under part 2F.1A?
 - i. The member must have leave under s 236(1). - *See below!*
 - ii. Apply the test for leave applications under s 237(2). - *See below!*
 - iii. Consider the outcome under s 241. - *See below!*
 - iv. *Apply case analogies!*
 - d. Will the plaintiff seek a statutory injunction under s 1324?
 - i. The plaintiff must establish standing under s 1324. - *See below!*
 - ii. Will the plaintiff satisfy the requirements? - *See below!*
 - e. Will the plaintiff seek to wind up the company under ss 461 and 462?
 - i. This will be a small part of your answer as it is an extreme remedy and will not be done if something else is appropriate: *ASIC v ABC Fund Managers*
 - ii. Consider standing under s 462. - *See below!*
 - iii. Consider grounds under ss 461(e), or 461(f)&(g), or 461(1)(k).
 - iv. *Apply case analogies!*
 - f. Will the plaintiff enforce their statutory right to inspect books? - *See below!*
 - g. Will the plaintiff seek to call a meeting? - *See below!*
 - h. Will the plaintiff seek to challenge a variation of class rights? - *See below!*
 - i. Will the plaintiff seek to challenge a procedural irregularity of the calling of a meeting? - *See below!*
- 9. Is there a receivership issue on the facts?**

- a. Is the receiver a person who can be a receiver?
 - i. Section 418 requires them to be a registered liquidator, under s 9 CA.
 - b. Note the commencement of the receivership. - *See below!*
 - c. Is the appointment of the receiver valid?
 - i. S 427 requirements. - *See below!*
 - ii. Can apply to court for declaration of validity under s 418A. - *See below!*
 - iii. CA s419(3) exonerates receiver if assumed control with a reasonable belief the appointment was proper
 - d. Note the effect of the receivership on the company. - *See below!*
 - e. Note the duties of a receiver:
 - i. To the company:
 - 1. **The company may have an action against a receiver under s 420A. - *See below!*
 - 2. Receivers owe contractual and equitable directors' duties.
 - 3. Further, receivers are 'officers' within s 9 CA, so they owe duties accordingly under ss 180-184 CA.
 - ii. To the secured creditor:
 - 1. **The creditor may have an action against a receiver under s 420A. - *See below!*
 - 2. Could also have an action for breach of the appointment agreement.
 - 3. An agency relationship arises between a receiver and creditor. So, the creditor may also have an action against a receiver for a breach of this fiduciary duty.
 - f. Consider the ranking and payment of creditors under s 433. - *See below!*
 - g. Consider when the receivership is terminated - *See below!*
10. **Will be no Voluntary Administration issues in the exam!** - *See below for notes anyway, just in case!*
11. **Any liquidation issues?**
- a. Is the liquidator a valid insolvency practitioner?
 - i. See s 1282 and part 5 CA. - *See below!*
 - b. Has the liquidation validly commenced?
 - i. Member's voluntary liquidation under s 494? - *See below!*
 - ii. Creditor's voluntary liquidation? - *See below!*
 - iii. Compulsory (court) liquidation under s 459P? - *See below!*
 - c. Consider the powers and duties of the liquidators. - *See below!*
 - d. Consider the effect of liquidation. - *See below!*
 - e. **Note the order (priorities) of payment under s 556. - *See below!*
 - f. Consider deregistration. - *See below!*
12. **Will the liquidator bring a voidable transactions action?**
- a. What categories will the transactions fall into?
 - i. Insolvent transaction: - *See below!*
 - 1. Unfair preferences under s588FA(1) OR,
 - 2. Un- commercial transaction under s 588FB,
 - 3. AND, the company insolvent at time of or as result of transaction.
 - ii. Voidable security interest under s 588FJ. - *See below!*

- iii. Unfair loans under s 588FD. - *See below!*
- iv. Unreasonable director related transactions under s 588FDA. - *See below!*
- v. Insolvent transaction for the purpose of defeating, delaying or interfering with a creditors rights upon winding up under s 588FE(5). - *See below!*
- b. Were the transactions entered into within the relevant period under s 588FE(2). - *See below!*
- c. What can the court order under s 588FF? - *See below!*
- d. Any defences?
 - i. The continuing business relationship defence under s 588FA(3). - *See below!*
 - ii. The s 588FG defense. - *See below!*

Business Structures

Note: The Corporations Act became operative on 1 July 2001, and is enforced on a national basis by Commonwealth bodies like ASIC.

1. Consider factors that influence the ownership structure: *Ensure mention all of these when giving advice!*

- Cost of the structure
- Regulatory burden associated with the structure
- Tax implications
- Legal liability of owners
- Desired longevity of the business
- If there is a desire to sell - the ease of achieving this
- Ability to raise capital
- Ability to exercise control
- Nature of the business (manufacturing, retail, services)
- Number of persons involved

2. Is a Sole Trader ownership structure appropriate?

Definition: Business owned and operated by an individual.

- *Has no 'legal' structure*
- *The business is essentially the owner*

Features

- **Advantages:**
 - Simplest structure
 - Owner has total control over the operation of the business. No consultation with anyone else is required.
 - The sole trader will retain all of the profits, and need not share.
 - Due to the comparative lack of formal regulation, there is little need for sole traders to disclose the details of their business.
 - Low cost/low regulatory burden
 - No regulatory burdens that are not also imposed on everyone else. Minimum formalities to be met
 - Sole traders must register their business name unless it is their full name: Regulatory Guide 235, ASIC.
 - \$34 for one year, or \$79 for three years.
 - Since mid-2012 ASIC has taken over the national scheme of registration for business names
 - Tax is paid at the individual marginal tax rate.
 - This could be beneficial if earn enough so your rate is below 30%.
- **Disadvantages:**
 - Owner has unlimited liability

- Owner is responsible for all liabilities the business incurs. Hence, the owner can be forced to sell assets to sell debts.
 - All of the risk is therefore with the owner.
- Business has no separate legal identity
- Managing the business can place an enormous strain on the sole trader. And, they can be limited in the expertise they possess.
 - The trader must also provide all of the capital for the business. It will have trouble raising finance from the bank unless it has adequate asset backing.
 - Difficult to sell/raise capital
 - It is harder for an individual to get money from the bank. There is no formalized method to raise money from the public.
- The business will cease to operate if the sole trader becomes permanently incapacitated or dies. No perpetual succession!

3. Is the Partnership ownership structure appropriate?

Definition: the relation which subsists between persons carrying on a business in common with a view to profit: *Partnership Act 1891 (SA) s 1*.

- Includes an incorporated limited partnership
- Excludes a corporation

Elements: See s 1(b) *Partnerships Act*

- ‘Between persons’: Must be more than one person, but below 20 per s 150 *Corporations Act*.
- ‘Carrying on a business’: Must be an element of repetition or intention to repeat activities. Not a single transaction
- ‘In common’: Each partner must be a principle in the business
- ‘Business’: This includes any trade, occupation or profession
- ‘View to profit’: Profit is intended to be generated from being in the partnership. It is not a non-for-profit organisation.

Features

- **Advantages:**
 - Relatively informal and inexpensive to establish and maintain.
 - No formalities are necessary to establish a partnership – although a written agreement is recommended.
 - Must comply with tax requirements and register the business name if different from the partners.
 - Partners have flexibility in their decision making
 - Ordinary matters connected with the partnership may be decided by a majority of partners.
 - But, not change may be made to alter the nature of the partnership without the consent of all existing partners.

- Support is also available from the other partners – ‘two heads are better than one’.
 - Partnerships enjoy a high degree of privacy from public scrutiny because they are not required to divulge confidential information to any monitoring agency, unlike a company.
 - The partnership profits form part of the taxable income of the individual partners
 - Could be beneficial if paying below a 30% rate
- **Disadvantages:**
 - No separate legal identity
 - Partners/owners have unlimited personal liability for debts incurred in the conduct of the business: ss 9-12 PA
 - Each partner is liable for the actions of the other partner(s). – mutual agency: *Mercantile Credit*
 - Each partner is the agent of each other partner when carrying on the business: s 5 PA
 - Partners are jointly and severably liable
 - Partnership lacks existence separate from its members and so lacks permanence.
 - Capital may also be hard to raise without adequate asset backings. Must rely on savings.
 - In the absence of a contrary agreement, a partnership is dissolved by the death or insolvency of a partner: s 33 PA
 - Can be an issue as the partners must have to repeatedly change the partnership agreement if they want to add or remove partners.
- **Other features:**
 - The rights and obligations of the partners are determined by reference to the partnership agreement and the relevant Partnership Act
 - Partnership is not taxed but a partnership tax return must be lodged

Determining the existence of a partnership – Courts look to substance, not the name/form

- The existence of the following does not necessarily indicate that there is a partnership: s 2 PA
 - Holding of property jointly
 - Sharing of gross returns
 - Sharing of profits is prima facie evidence of partnership
 - Examples of payments from profit that are not indications of partnership
 - Payment of debts
 - Payments to employees or agents
 - Payments to spouse of deceased partner
 - Advances to someone with repayments varying according to profit
 - Payments to someone who has sold the goodwill in the business
- At common law the courts will weigh up a number of factors in order to determine the intentions of the parties
 - Sharing of profits and losses
 - Whether the ‘partners’ are principals

- If they accept they are principals and agents of each other
- Role in management/the business
- ‘mutual confidence is the life blood of the concern’: *Birchnell v Equity, Trustees, Executors and Agency Ltd* (1929) 42 CLR 384, 407 (Dixon J)
- Contribution of capital
- Partnership agreement

4. Is a Corporate structure appropriate?

Definition: a corporation includes a company, and a body corporate, and a unincorporated body with features of corporation: s 57A CA

Features

- **Advantages:**
 - Separate legal entity from its shareholders, directors, officers and employees.
 - Thus, it may own property, enter into contracts and sue or be sued.
 - The legal capacity and powers of a corporation include the capacity and powers of an individual and a body corporate (s 124 CA).
 - Per s 124(1) this includes:
 - Issuing shares and debentures
 - Granting options over unissued shares
 - Distributing the company’s property among its members
 - Granting a security interest in uncalled capital
 - Granting a circulating security interest over the company’s property
 - Going anything it is lawfully authorized to do.
 - Perpetual succession
 - The existence of the corporation does not depend on its owners being alive. Thus, its’ lifespan is potentially unlimited.
 - It will continue to exist until it is deregistered by ASIC (s 601AD(1) CA).
 - Transferability of shares is also an advantage. Shareholders can sell or transfer shares (usually) without restriction.
 - Limited liability
 - Shareholders are not personally liable for the company’s debts.
 - The most common limitation structure is ‘limited by shares’ where the shareholders are only liable for the unpaid amount owed on the shares they own: s 516 CA.
 - Thus, the risk of failure is burdened by the creditors and not the shareholders.
 - Flexibility about raising capital and financing
 - Tax advantages as taxed at flat rate of 30%
 - If person’s individual tax rate would be above this
- **Disadvantages:**
 - High cost/regulatory burden

- Reduced if small proprietary company – *see below*.

Types: Every registered company is either a public company or a proprietary company: s 112(1) CA. *Corporations Act 2001* (Cth) s 112(1) provides that the following types of companies can be registered under the Act:

- Proprietary companies:
 - Limited by shares or,
 - Unlimited with share capital
- Public companies:
 - Limited by shares or,
 - Limited by guarantee or,
 - Unlimited with share capital or,
 - No liability

Public company: A company other than a proprietary company: s 9 CA

- Generally subject to more onerous obligations

Proprietary company: defined by s 113 CA

- 50 shareholder rule: A company limited by shares or unlimited with share capital with no more than 50 non-employee shareholders
- Must not engage in any behavior which requires disclosure under Ch 6D CA, such as issuing shares or debentures, with the exception of offers of shares to existing shareholders or employees, or to its subsidiaries.
 - *Restrictions on ways they can raise revenue!*

| | Proprietary | Public |
|--|--|---|
| Number of members | At least one [s 114] but no more than 50 non-employee members: s 113(1) CA | At least one: s 114 CA. No upper limit. |
| Minimum number of directors: s 201A CA | One [must ordinarily reside in Australia]: s 201A(1) CA | Three [at least 2 must ordinarily reside in Australia] s 201A(2) CA |
| Must have a company secretary? | No | Yes: s 204A(2) CA |
| Must hold an annual general meeting? | No | Yes: s 250N(1) and (2) CA |
| Registered office must be open to public for at least 3 hours each day? | No | Yes: s 145(1) CA |
| Company name and the words "Registered Office" must be displayed at registered office? | No | Yes: s 144(2) CA |
| Do members have a statutory right to remove directors? | Replaceable rule s203C CA | Yes: s 203D CA |

Small proprietary companies - Note, this cannot be established. It is a classification that can change each year!

- A proprietary company is considered to be a 'small proprietary company' in a financial year if *at least 2 of the following 3 criteria are satisfied* (s 45A(2) CA)
 - Its consolidated gross operating revenue for the year is less than \$25m
 - Its consolidated gross assets are valued at less than \$12.5m at the end of the financial year
 - It, and entities it controls, have fewer than 50 Full Time Equivalent employees at the end of the year
- Unlike large proprietary companies, small proprietary companies are not required to prepare an annual profit and loss statement or an annual balance sheet: s 292(1)(2) CA
 - Provides advantages to small proprietary companies in relation to disclosure requirements and recurring costs such as audited annual reports
 - Must still prepare full reports if requested by ASIC (s 294) or by shareholders with at least 5% voting rights (s 293).
 - *Smaller regulatory burden!*

4a. Will it be a Public Company?

- Not all public companies are listed on the Australian Securities Exchange ('ASX'), but those which are have a greater ability to raise capital through the trading of their shares
- If a public company does wish to list on the ASX, it must first comply with the additional regulations in the ASX Listing Rules
 - Throughout the life of its listing, it must remain in compliance
- Further requirements are placed by the CA on listed public companies, for example
 - Annual directors' reports: s 300A CA
 - Disclosing entities: Pt 1.2A CA
 - Continuous disclosure: Pt 6 CA

ASX – minimum requirements (ASX Listing Rule 1)

- Shareholder minimum
 - 500 shareholders each holding a parcel of shares with a value of at least \$2,000; or
 - 400 shareholders each holding a parcel of shares with a value of at least \$2000, 25% of whom are unrelated parties of the company
- Size minimum
 - Profits test – aggregated profits from continuing operations for the last three financial years of at least \$1 million; or
 - Assets test – net tangible assets of at least \$2 million

Conversion between Pty Ltd and Ltd

- Proprietary companies can convert to public for a number of reasons
 - In anticipation of listing on the securities exchange
 - Due to growth causing a contravention of s 113 CA
 - To raise capital from the public

- Pty Ltd can convert to Ltd by passing a special resolution and lodging an application with ASIC: ss 162-163 CA
- ASIC can order such a conversion if it is satisfied a company has contravened s 113: s 165 CA
- Public companies may wish to convert to proprietary for a number of reasons, but most commonly to reduce the financial disclosure obligations
 - Same procedure under ss 162-163 CA

4c. Consider Liability of members

Limited liability by shares: Company where the liability of members is limited to any amounts remaining unpaid on their shares (if any): s 9, 516 CA

- The company's liability is not limited, only that of its shareholders
- Companies limited by shares are usually referred to as limited liability companies (*Stark Pty Ltd or IronMan Ltd*: s 149 CA)

Share capital: the total amount of money or other property that investors provide to the company in consideration for the shares issued to them: LHW p 208

- Historically afforded great significance – as what creditors were entitled to rely upon as a source of payment for their debts, hence an obligation upon companies to 'maintain share capital'

A share: a proportionate interest of a shareholder in the net worth of the company: LHW p 209

- Also known as a 'chase in action'
- Rights associated with a share are determined by general law, terms of issue, CA, and the constitution of the company

Limited liability by guarantee: A company formed on the principle of having the liability of its members limited to the respective amounts that the members undertake to contribute to the property of the company if it is wound up: s 9 CA

- A company limited by guarantee cannot issue shares: s 124(1) CA
 - Hence companies limited by guarantee do not have share capital
- If a company limited by guarantee is being wound up and has insufficient assets to meet its liabilities, its members are liable for the amount specified as their members' guarantee
- They are generally unsuitable for trading ventures
 - Doesn't raise any initial working capital from its members.
 - Predominately used for not-for-profit organisations

Unlimited liability with share capital: A company whose members have no limit placed on their liability: s 9 CA

- A member is liable to pay to the company whatever the company requires in order to discharge its debts, even though the issue price of the shares held by the member may have been fully paid up

- As such, a member is liable in winding up for any debt of the company if the company has insufficient assets to meet its debts
- The unlimited liability company is used by professionals such as lawyers and accountants, as professional rules can prohibit them from incorporating with limited liability

No liability: A corporate form developed to encourage mining.

- To be eligible for registration as a no liability company:
 - The company must have a share capital
 - Its constitution must state that: s 112(3) CA
 - Its sole objects are 'mining purposes' (as defined by s 9 CA)
 - It is prohibited from engaging in activities outside of its mining purpose objective
 - The company must have no contractual right under its constitution to recover calls made on its shares from a shareholder who fails to pay them: s 112(2) CA
 - Must have NL in its name: s 148(4) CA
- If a call is unpaid 14 days after it should have been paid, the relevant shares are forfeited to the company: s 254Q(1) CA
- The company's directors must then offer them for sale at a public auction within 6 weeks after the call becomes payable: s 254Q(2)-(3) CA
- If a reserve price for the shares is not met, then the shares must be disposed of according to the company's constitution or a resolution: s 254Q(7)-(9) CA

5. Is a Trading Trust appropriate? A trust created for business purposes

- One or more individuals vest business assets in a trust fund
- The business is managed by a trustee
 - Trustee is personally liable for debts incurred in running the business
 - Trustee is entitled to be indemnified out of trust assets for properly incurred expenses
 - Trustee does not usually have a right to be indemnified by the trust beneficiaries
- Trust does not have to be registered
- The trust itself is neither a legal entity nor a taxable entity
- A tax return for a trading trust must be lodged with the ATO each year
- Distributions from the trust represent taxable income in the hands of the beneficiaries
- Trading trusts are subject to the general law and, in particular, trust law
- Tax laws usually dictate whether a trading trust is an appropriate business structure

6. Is a Managed investment scheme appropriate?

- A scheme where assets contributed by persons are pooled or used in a common enterprise to produce financial benefits, or rights or interests in property, for the contributors: s 9 CA
 - Contributors (as contributors) must not have day-to-day control over the operation of the scheme
- Regulated by chapter 5A CA

- Must be registered if they have more than 20 members/contributors: s 601ED(1)(a) CA
- A registered MIS must be managed by a public company which has an appropriate Australian financial services licence: s 601FA CA

7. Is an Incorporated Association appropriate? An association registered under the *Associations Incorporation Act 1985 (SA)*

- Instead of registering as a company limited by guarantee, a non-profit group might prefer to gain the benefits of corporate status under state and territory non-profit legislation such as the *Associations Incorporations Act 1985 (SA)*

8. Note the Registration process for companies:

- Required process for companies
 - For registration: Part 2A.2 CA
 - The required information: s117(2) CA
- Lodge Form 201 with ASIC
- Registration fee: An Australian company having share capital pays a fee of \$463
- Upon registration an ACN and a certificate of registration are given

8a. Effect of registration:

- A company comes into existence as a body corporate at the beginning of the day on which it is registered with the name specified in its certificate of registration (s 119 CA).
- Once registered, a company has the legal capacity and powers of an individual both within Australia and elsewhere
 - s 124 provides general power ('all the powers of an individual') and a specific non-exhaustive list of additional powers
- A company can, for example
 - Contract as principal or agent
 - Hold the legal or equitable title to property as principal or as a trustee
 - Sue and be sued in its own name
 - Employ persons
- **Limited liability company:**
 - It is considered a separate legal entity from its members and directors
 - This means that the main risks associated with business failure shift to the creditors of the company
 - In general where a company incurs a debt, the creditors can only seek payment from the company itself and not the members or directors

Separate legal entity principle:

- A sole trader can gain limited personal liability by setting up a registered company to carry on the business
- The current legislation requires a company to have at least 1 member: s 114 CA
 - The business can then be considered a separate legal entity

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| <i>Salomon v Salomon & Co Ltd</i> | <p>Mr Salomon was a successful boot manufacturer who carried on his business as a sole trader. He decided to form a company. Members of the company were Mr and Mrs Salomon and their five children. Each of the seven family members held one fully paid £1 share. The company purchased Mr Salomon's business for £39,000, issued Mr Salomon with 20,000 fully paid £1 shares, issued Mr Salomon with a £10,000 debenture, discharged about £8,000 worth of liabilities that Mr Salomon had incurred as a sole trader and paid Mr Salomon £1000 cash. Mr Salomon borrowed £5,000 from Broderip and on-lent it to the company. The company defaulted on the loan. Broderip appointed a receiver. The liquidator sought to hold Mr Salomon responsible for all of the company's debts, and disputed the validity of the debentures on the ground of fraud.</p> | <p>The House of Lords Court unanimously upheld Salomon's appeal.</p> <p>Company had been formed with at least 7 members, as required by the legislation in force at that time. It was a separate legal entity capable of acquiring and operating a business as principal. It could not be regarded as a mere alias or agent of its controlling shareholder.</p> <p>'The order of [Vaughan Williams J] appears to me to be founded on a misconception of the scope and effect of the <i>Companies Act 1862</i>. In order to form a company limited by shares, the Act requires that a memorandum of association should be signed by seven persons, who are each to take one share at least. If those conditions are complied with, what can it matter whether the signatories are relations or strangers?': Lord Macnaghten.</p> <p>The House of Lords considered the sale by Mr Salomon of his business to the company was transparent and valid</p> <p>The Court assumed that all members of the company</p> |
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| | | were aware of the true state of the business and its value. Thus no member of the company, or the company itself, had been defrauded even if the company paid too much. |
| <i>Lee v Lee's Air Farming Ltd</i> [1961] AC 12 | Lee was a pilot who conducted an aerial top-dressing business. HE formed a company to conduct the business. Lee owner 2999 shares, and his nominee owned 1 share. Lee was the director, and also an employee. Lee died while undertaking his business and his widow claimed workers compensation. | The HoL held that the claim should succeed. The business was a separate legal entity distinct from its founder. IT could enter into a contract fo employment with Lee. |
| <i>Macaura v Northern Assurance Co Ltd</i> [1925] AC 619. | Macaura owned land on which stood timber. He sold the land and the timber to a company he formed and received shares as consideration. A fire destroyed all of the timber. Macaura did not insure the timber under the company, only under his own name. | The HoL held the insurers were not liable; only the company could insure the timber against loss or damage. Shareholders have no interest in the company's property. |

Piercing the Corporate Veil: 'Lifting or piercing the corporate veil' involves a court holding that members of a company are liable for a debt that the company alone would usually be responsible for as principal

1. State: Plaintiff may have an action against Defendant Pty Ltd in order to [enforce the contract]. Plaintiff will seek specific performance of the contract, or at the very least, damages. However, Defendant is an incorporated company, and is a separate legal entity to its' owners. As a result, Plaintiff will need to pierce the corporate veil.

2. Can the veil be pierced under the Common law?

Australian courts, and in particular the High Court, are *very* reluctant to imperil the *Salomon* principle by lifting the corporate veil, but will do so where:

- The company is a vehicle for fraud
 - *Re Darby* [1911] 1 KB 95
- The company is used to avoid a legal obligation under contract or statute
 - *Gilford Motors Co Ltd v Horne* [1933] Ch 935
 - *Jones v Lipman* [1962] 1 WLR 832
- The company knowingly participates in a directors' breach of a fiduciary obligation
 - *Green v Bestobell Industries Pty Ltd* [1982] WAR 1
- In order to attribute the mind of an individual to the purpose why a company has behaved a certain way
 - The Court can look to the 'directing mind and will' of a company (not mere employees), to determine its attitude or intention: *Supermarkets Ltd v Natrass*

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| <i>Re Darby</i> [1911] 1 KB 95 | Darby and Gyde formed a company of which they were the sole directors and (with 5 nominees) the shareholders. The company purchased a quarry licence and then floated another company to purchase the licence at a substantial overvalue. The new company failed and the liquidator claimed the profits made by Darby. | The HoL found that the profit was made by Darby himself, and not the company. Darby was ordered to disgorge his profit as the company he set up was a "dummy company" formed for the purpose of allowing him to perpetuate a fraud. |
| <i>Gilford Motors Co Ltd v Horne</i> [1933] Ch 935 | Horne was managing director of Gilford Motors. His contract specified he was not to solicit or entice customers away after his term of employment. Horne resigned and started his own competitor business (a company, the shareholders being his wife and an associate). He sent circulars around to old customers seeking their business. Gilford bought an action to restrain him from doing this. | Gilford was successful, and an injunction was granted against both Horne and his company – even though it was not a party to the contract. Lord Hansworth MR considered the company was a "mere cloak or sham". |
| <i>Jones v Lipman</i> [1962] 1 WLR 832 | Lipman was a vendor of land who entered into a contract for the sale of the land to Jones. Lipman sought to avoid the contract by forming a company | It was held the company created was a façade and Jones succeeded in obtaining an award for specific performance against both Lipman and the |

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| | in which he and a nominee were the only directors and shareholders. The company bought the land at a substantial undervalue. | company because Lipman had absolute control and ownership of the company which was a “device and a sham”. |
| <i>Green v Bestobell Industries Pty Ltd</i> [1982] WAR 1 | Green, the Victorian managers of Bestobell, became aware that Bestobell was preparing a tender for certain construction works. Without permission or consent, Green incorporated his own company and submitted a successful tender. | The WA Supreme Court held Green had breached his fiduciary duty owed to Bestobell. As his business had knowingly and for its own benefit participated in Green’s breach, it was ordered to account to Bestobell for the profits it received. |

2. Can the veil be pierced through Statutory law?

Some statutory provisions can be regarded as ‘lifting or piercing the corporate veil’

- ****Directors’ liability for insolvent trading – s588G CA**
 - If directors breach their duty to prevent the company incurring debts when there are reasonable grounds to suspect that it is insolvent. These directors will be liable to pay compensation equal to the loss or damage suffered by unsecured creditors: ss 588J, 588K, 588M CA.
- ****Uncommercial transactions**
 - Directors or other related entities cannot be treated differently from others who have dealings with the company.
 - The liquidators can set aside any uncommercial transaction entered into within two years of the commencement of the winding up: s 588FD(3) CA.
 - If the recipient is a director or related entity of the company, the liquidator can void uncommercial transactions entered into within four years of the winding up.
- **Security interests granted to officers**
 - Per s 588FP CA, officers who lend money to their company secured by a credit interest over its property are treated differently from arm’s length creditors.
 - Per s 588FP(1) a security interest granted by a company is void if the secured party is an officer, former officer, or a person associated with either of the latter and the secured party purports to enforce its security interest within the 6 months it is made without permission from the court.
 - Steps to enforce per s 588FP(3) include:
 - Appointing a receiver
 - Entering possession or assuming control
 - Seizing the property to enforce the security interest
- Financial assistance
- Taxation legislation

Corporate groups

1. Is there actually a corporate group? A 'corporate group' can be defined in two ways under the *Corporations Act*

1. Companies that are 'related' to each other: s 50(a)-(b) CA

I.e. if there is a 'holding company' and 'subsidiary company' relationship, or they are both subsidiaries of the same holding company.

- Where a body corporate is
 - a holding company of another body corporate; or
 - Per s 9 CA a 'holding company', in relation to a body corporate, means a body corporate of which the first body corporate is a subsidiary
 - a subsidiary of another body corporate; or
 - Per s 46 CA a body corporate is a subsidiary of another body corporate if, and only if:
 - (a) the other body
 - (i) controls the composition of the first body's board; or
 - = legally enforceable ability to appoint or remove all or a majority of the directors: s 47 CA
 - Practical or de facto control on the basis of a significant shareholding does is not sufficient (*Mount Edon Gold Mines (Aust) Ltd v Burmine Ltd*)
 - (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; or
 - Control the casting = legally enforceable power
 - Position to cast = broader than "control" (*Bluebird Investments Pty Ltd v Graf Holdings Pty Ltd*)
 - (iii) holds more than one-half of the issued share capital of first body (excluding any part of that capital that carries no right to participate beyond a specified amount in a distribution of either profits or capital); or
 - Definition of 'holds' = registered shareholder
 - Exception: nominee shareholders: s 48(3) C
 - This is when a company holds shares on trust for another company
 - (b) the first body is a subsidiary of a subsidiary of the other body: s 50(c) CA.
 - a subsidiary of a holding company of another body corporate;

Note: per s 9 CA an 'ultimate holding company' is a holding company of the first-mentioned body; and is itself a subsidiary of no body corporate.

A company is a 'wholly-owned subsidiary' if none of its members is a person other than:

- *Its own holding company*

- A nominee of its holding company
- Another wholly owned subsidiary of the holding company
- A nominee of such a wholly-owned subsidiary

2. When one entity 'controls' another: s 50 AA CA

- (1) 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.
 - An entity is defined by s 64A to include a natural person, a body corporate (other than an exempt public authority), a partnership and a trust (including trustee) – so it applies broader!
- (2) In determining whether the first entity has this capacity:
 - (a) the *practical influence* the first entity can exert (rather than the rights it can enforce) is the issue to be considered; and
 - (b) *any practice or pattern of behaviour affecting* the second entity's financial or operating policies is to be taken into account (even if it involves a breach of an agreement or a breach of trust).
- (3) The first entity does not control the second entity merely because the first entity and a third entity jointly have the capacity to determine the outcome of decisions about the second entity's financial and operating policies.
- (4) If the first entity:
 - (a) has the capacity to influence decisions about the second entity's financial and operating policies; and
 - (b) is under a legal obligation to exercise that capacity for the benefit of someone other than the first entity's members;
 the first entity is taken not to control the second entity.

2. Can the corporate veil be pierced within the group?

Companies within corporate groups are usually treated as separate legal entities. So, other organizations will not be liable for another company's debts etc.

1. Consider: In limited scenarios, a corporate group may be treated as a single economic entity

1. Liability for the insolvent trading of a subsidiary: ss 588V-X CA
 - a. Where the business of the subsidiary has been directed or controlled by the holding company, and had reasonable grounds to expect that the subsidiary was insolvent
 - i. The corporation is the holding company of a company at the time when the company incurs a debt: s 588V(1)(a) AND
 - ii. The company is insolvent at that time, or becomes insolvent by incurring that debt, or by incurring at that time debts including that debt: s 588V(1)(b) AND
 - iii. At that time, there are reasonable grounds for suspecting that the company is insolvent, or would become insolvent, as the case may be: s 588V(1)(c) AND
 - iv. One or both of the following applies:

1. The corporation, or one or more of its directors, is or are aware at that time that there are such grounds for so suspecting: s 588V(1)(d)(i) AND/OR
2. Having regard to the nature and extend of the corporation's control over the company's affairs and to any other relevant circumstances, it is reasonable to expect that: 588V(1)(d)(ii)
 - a. A holding company in the corporation's circumstances would be so aware; 588V(1)(d)(ii)(A) OR
 - b. One or more of such a holding company's directors would be so aware; 588V(1)(d)(ii)(B) AND
 - v. That time is at or after the commencement of the Act 588V(1)(e)
- b. Can recover from the holding company amounts equal to the amount of loss or damage suffered by the subsidiary's unsecured creditors.
- c. A debt is incurred when a company "so acts to expose itself contractually to an obligation to make a future payment of a sum of money as a debt": *Hawkins*
 - i. Exposing oneself to an obligation to pay tax is a debt: *Powell*
2. Consolidated financial statements – AASB 10
 - a. To provide meaningful financial information to investors and the market.
3. Large and small proprietary companies – to determine look at consolidated figures
4. Taxation consolidation
5. Directors' duties – 'for the benefit of the group as a whole'
6. Pooling in liquidation
 - a. Statutory pooling mechanism for companies comprising a corporate group which enters into liquidation – able to be treated as a single entity, jointly and severally liable for each debt payable. Consent of unsecured (and unrelated) creditors is required
7. Subsidiaries as agents or partners (*Smith, Stone & Knight Ltd v Birmingham Corporation*)
 - a. If a parent exercises a degree of control over a subsidiary such that the subsidiary is an agent of the parent, its acts will be deemed the acts of the parent – *See six points below to determine!*
8. Tort liability
 - a. A parent may be directly liable to employees of subsidiaries on the basis that the parent owed a duty of care to the employee under negligence
 - i. Most likely to arise where the controlling company exercises a high degree of control over the day-to-day activities of its subsidiary out of which the tort claim arose: *CSR Ltd v Wren*; *CSR Ltd v Young*
 - b. *See textbook page 50 for cases.*

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| <p><i>Smith, Stone & Knight Ltd v Birmingham Corporation</i></p> | <p>Birmingham Corp, a local government authority, sought to compulsorily acquire land owned by Smith. Birmingham Waste was a subsidiary of Smith and conducted business on the land. Birmingham Corp refused to pay compensation as the subsidiary's tenancy was for less than 12 months. Smith asserted they were entitled to compensation as they conducted business on the land, as the subsidiary was their agent.</p> | <p>Smith succeeded. Atkin J found six requirements (upheld in <i>Aus by Spreag</i>):</p> <ol style="list-style-type: none"> 1. the profits of the subsidiary must be treated as profits of the holding company 2. the persons conducting the business must be appointed by the holding company 3. the holding company must be the brain of the venture 4. the holding company must govern the venture and decide what should be done and what capital should be invested 5. the profits of the business must be made by the holding company's skill and discretion 6. the holding company must be in effectual and constant control. <p>-> Advice is not effectual control -> Must be followed by subsidiary -> Must be constant rather than sporadic</p> |
| <p><i>Spreag</i></p> | <p>Holding company was found liable for the misleading and deceptive statements made by its' subsidiary and for breaches of implied terms of a contract by the subsidiary.</p> | |