1. Introduction

1.1 What is a Company?

✦ *A corporation (also known at common law as a "body corporate") in the common law sense (as distinct from the special provisions of s 57A of the Corporations Act) is a legal device by which legal rights, powers, privileges, immunities, duties, liabilities and disabilities may be attributed to a fictional entity equated for many purposes to a natural person.*

Corporations Act 2001 (Cth)
PART 1.2----INTERPRETATION
Division 7--Interpretation of other expressions

> ***s 57A Meaning of corporation***
> *(1) Subject to this section, in this Act, corporation includes:*
> *(a)a company; and*
> *(b)any body corporate (whether incorporated in this jurisdiction or elsewhere); and*
> *(c)an unincorporated body that under the law of its place of origin, may sue or be sued, or may hold property in the name of its secretary or of an office holder of the body duly appointed for that purpose.*
> *(2) Neither of the following is a corporation :*
> *(a)an exempt public authority;*
> *(b)a corporation sole.*

1.1.1 Historical Development of the Corporation Form

Some key moments (in England) in the derivation of the modern company

✦ *Early boroughs and guilds (13th century - 1650)*
- *From the 13th century certain boroughs were granted franchises by royal charter, conferring "liberties" or privileges upon the municipal group.*
- *The privileges commonly included jurisdictional privileges for the borough court (exclusive jurisdiction), limited powers of self government.*
- *Other franchises commonly granted to boroughs included 'the right to perpetual succession, the right to sue in the group name, the power to hold lands and the right to use a common seal to identify acts on behalf of the borough'.*
- *With respect to guild ordinances, they prescribed the conditions upon which members might trade and the guild court exercised jurisdiction in all trade disputes. -- Outsiders were permitted to trade in the borough, if at all, only on terms dictated by the guild, terms which secured the trading advantage of its members.*

✦ *Incorporation by Royal Charter (1650) – 'regulated companies'.*
- *It became settled in England that a corporation aggregate could not arise spontaneously – it could be created only by the consent of the monarch expressed in a grant of a royal charter.*
- *The early form of the chartered corporation was the regulated company, effectively a limited purpose guild in which the member merchants engaged in foreign trade on their own account and risk, subject to regulations passed by the company.*
- *But the movement from individual to joint stock trade was gradual.*
- *The East India Company was incorporated by royal charter in 1600.*
- *Charters typically ceded to the company not only trading privileges but extensive powers of self-government in the region such as power to make laws, raise taxes, establish a currency, conduct wars and settle the peace.*

✦ *Incorporation by private Act of Parliament – An example is the NSW Water Board. – 'statutory companies'.*
- *In England, at least from the 16th century, parliament could create a corporation. – a petition for a grant of incorporation by private Act of Parliament was an alternative to a petition to the monarch for a charter.*

✦ *The rise of the joint stock company (or de facto incorporation)*
- *Commercial developments in the 18th century necessitated the raising of large sums of capital and encouraged the solicitation of funds from the public.*
- *However, it was not always possible for a new enterprise to obtain a charter or the passing of an Act.*
- *This led to the formation of large quasi-partnership known as joint stock companies.*
- *"Company" here meant simply association. It was an unincorporated association.*

- Unlike the position in a partnership in the strict sense, membership shares were issued on terms that they were transferable without the consent of other investors in the company. – This created opportunities for speculation in shares in joint stock companies and in some economic conditions a market boom could develop. – Such a boom occurred in the early part of the 18th century.

✦ The "bubble" and the "Bubble Act" – 1720 (no companies without legislative authority or royal charter)
- The Act was designed to outlaw joint-stock companies and after it was passed there was a massive market downturn.
- Parliament wanted to end the creation of joint stock companies which presumed to act as corporate bodies without a charter or statutory authority and which pretended to make their shares transferable without the authority of an Act of Parliament.
- The Bubble Act was on the books for 105 years but never enforced. It was repealed in 1825.

✦ The Deed of Settlement company (deed only binds subscribers – stock not freely transferable)
- Under this device, a large partnership would be constituted by a deed of settlement containing rules for government of the partnership. – Thus, the prohibition of the Bubble Act were effectively circumvented.
- Instead of a charter or act of incorporation, the basis of the unincorporated organisation has to be found in the articles of association which were, as a rule, in the form of a deed of settlement signed by those participating in the society.
- The deed provided that every person to whom a share was transferred would promise to perform all the duties of an investor as laid down in the deed. Transferees of shares agreed to be bound by the deed and signed a supplementary deed. For matters not dealt with in the deed, the general law of partnership applied.
- The deed provided that stockholders should be liable only to the extent of their contributed capital.

✦ Repeal of the "Bubble Act" – 1825

✦ Joint Stock Companies Registration and Regulation Act 1844 (UK).
- The Act was passed establishing accountability mechanisms through obligations with respect to the holding of company meetings and the audit and publication of company accounts.
- The Act adopted the constitutional structure of the deed of settlement company.

✦ Limited Liability Act 1855 (UK): first allowed limited liability for corporations.

✦ Joint Stock Companies Act 1856 (UK).
- A consolidating statute provided for incorporation on the application of seven persons.
- The deed of settlement gave way to two constitutional documents, the memorandum of association and the articles of association.

✦ Companies Act 1862 (UK): First 'Companies Act'. – this is the act which was brought to Australia.

The Australian experience

✦ Pre-1901: colonies adopted individual legislation

✦ 1901: at federation, states retained legislative power

✦ 1961-2: 1st national cooperative scheme

✦ 1981: 2nd national cooperative scheme

✦ 1991: 3rd national cooperative scheme

✦ 2001: after State referral to the Commonwealth, the Commonwealth enacted Corporations Act 2001 (Cth) (the current law).
- Referral power: s 51(xxxvii) of the Constitution.

1.1.2 Theories and Conceptions of the Corporation

Managerialist Theory

✦ The managerialist theory emphasises corporate management and the power that it wields.

✦ The issue is whether management holds and exercises this power legitimately.

✦ Critics of management argue that managers often exercise power without accountability to shareholders; in public companies, shareholders are unable to monitor effectively the managers of their companies, so that legal intervention is needed to protect the interests of shareholders.

✦ In the managerialist theory, accountability is secured by the imposition of mandatory legal duties upon directors and other officers. These include the duty to act honestly, to exercise care and diligence, not to make improper use of information acquired by virtue of being an officer of the company, and not to make improper use of position as an officer of the company.[1]

[1] s 232 of Corporations Act 2001 (Cth).

- In addition: corporate managers are subject to disclosure obligations.
- These legal duties and obligations may be enforced by the company itself, by shareholders, or by the Australian Securities Commission.

Concession / Privilege Theory

- A privilege is offered by the State to individuals to form corporation.
- High level of regulation in corporate affairs by the State said to be justified.
- Inappropriate to afford limited liability to small/sole proprietor companies because they don't contribute much to the economy and there is no separation of ownership and control.
- Since the state is the device which allows a corporation to be created and gives it its qualities, then as a quid pro quo, the state may require for that concession certain obligations on companies (i.e. can tax them etc.).

Contractual Theory

- Under the contractual theory, the corporation is deconstructed to reveal no more than a "nexus of contracting relationships" between shareholders, managers and other employees, lenders, suppliers and other stakeholders.
- The contracting relationships are a conception of "relationships characterised by reciprocal relations and behaviour".
- Thus, competitive markets are more important than mandatory legal rules in providing managers with appropriate incentives to maximise shareholder wealth. –Contract theory rests upon the assumption that the duty of management is to maximise the wealth of their principals, the shareholder owners of the firm and that the function of corporate law is to promote that end.
- As a consequence, since the firm is no more than a web or nexus of contracts, the view of corporation as hierarchy disappears and with it the so-called problem of management accountability and legitimacy.
- In addition, the role of corporate law and state regulation also declines since the contracting parties as rational utilitarians are entitled to structure their relations as they wish. – Corporate law is useful to catch management fraud and as a standard form contract which reduces the transaction costs of negotiating an optimal contract afresh each time. – thus, under contract theory, corporate law is permissive and supplementary.

Shareholder Approach

- Shareholder primacy – the only reason for directors to decide anything at all is to make the most money for the shareholders.
- Shareholders as owners of the corporation: ultimate risk bearers (provide capital but financial claims postponed to creditors when winding up), entitlement to surplus income during life of company and control exercised by voting rights.
  - View prevalent in the 19th century
  - Believed that the greatest benefits achieved when companies acted so as to maximise the profits distributable to their shareholders
  - Management accountable to shareholders (reflected in CL via directors duties)
  - In Dodge v Ford Motor Co. (1919) 170 NW 668, it was held that the director of the Ford Motor Co. was accountable to the company's shareholders for unpaid dividends even though these dividends had been reinvested in the company to make their cars cheaper for society.

Stakeholder Approach

- Stakeholder could be:
  - employees who, without the company, would not have jobs
  - bondholders who would like a solid performance from the company and, therefore, a reduced risk of default
  - customers who may rely on the company to provide a particular good or service
  - suppliers who may rely on the company to provide a consistent revenue stream
- There is an overriding need to think of the corporate entity as having a public vision, and so therefore there should be controls on countries that require directors to have other concerns.
- Multi-fiduciary obligations – duty owed by corporate managers to all stakeholders and not merely shareholders (ie no preferring of short term shareholder gains over legitimate non-shareholder expectations). Management should pursue profit seeking strategies that harmonise shareholder and non- shareholder interests.
  - Recognition of interests of debtors, creditors, employees, suppliers, consumers and the public.
  - Stakeholders cannot seek remedies against directors hence not widely adopted in Australia.

1.1.3 Policy Concerns

1.1.4 Types of Companies

	Proprietary Companies (Pty Ltd)	Public Companies (Ltd)
Shareholders: s 45A(1), Note 2; s 113	1-50.	at least 1, no maximum.
Members: s 114	Minimum: 1 member.	Minimum: 1 member.
Directors: s 201A	Minimum 1 director (1 resident).	Minimum: 3 directors (2 residents).
Finance: s 45A(1), Note 2; s 113	Cannot get fund from public.	Can get fund from public (with disclosure documents).
Listing: s 45A(1), Note 2; s 113	Cannot be listed.	Can be listed or unlisted.

Classification Accordingly to Liability

Corporations Act 2001 (Cth)
CHAPTER 2A--Registering a company
PART 2A.1----WHAT COMPANIES CAN BE REGISTERED

s 112 Types of companies
(1) 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

Share Capital

- Share capital is but a device to allocate certain risks, rights and functions among participants in the business venture, namely, the risk of loss, the distribution of profits and control of the venture.
- Share capital is that amount, in money or money's worth, which members of the company agree to contribute permanently to the company in their capacity as members to fund the joint enterprise or activities. It also includes other accumulations made during the life of the company without contribution by members, such as through the issue of bonus shares.
- On a winding up of a company, the holder of share capital are the lowest ranked claimants upon the assets of the company.
- During the life of the company share capital may not be returned to its holders, and those holders may not be released from obligations they have undertaken to contribute it, without formal approval.

Shares

- A share is simply a proportionate interest in the net worth of the business or undertaking of the company.
- It confers an interest in the company through a bundle of rights which are properly described as a chose in action since shareholders do not have any legal or equitable interest in the assets of the company.

- The rights attached to shares in a company are those which are conferred by the Corporations Act and general law doctrines of company law, the constitution of the company and the terms of issue of the shares. – two broad species:
  - to participate in financial distributions, being an entitlement to receive dividend payment and rights in a winding up of the company to be repaid proportionately.
  - to participate in the governance of the company.

✦ The power to issue shares in a company is usually vested in directors.
✦ The aggregate amount of money or its value (where shares are issued for a non-cash consideration) that has been received by the company for the issue of shares is called its paid up capital.
✦ The aggregate of issued capital for which payment has yet to be made is called its unpaid or uncalled capital.
✦ Types of shares
  - Ordinary/normal shares -- Standard rights include the right to dividends, the right to vote, the right to a return of capital on winding-up
    - Noteworthy, shareholders are bottom on the list of creditors so you only get your return of capital once everybody else has been paid.
  - Preference shares -- shares which have preferential right over other shareholders. Rights depend upon the issue of the shares but typically such shareholder has:
    - a right to a minimum dividend (preferential right to the distribution of profits);
    - right to be paid before ordinary shareholders in the winding up
    - more limited voting rights
  - Bonus shares – shares which are issued to existing shareholders without payment (dividend reinvestment): s 254A, CA.
  - Partly paid shares -- shares where the full issue price does not have to be paid at the time of issue (used if you want to have funds on call but do not need all of the capital in the company at the start). This type of share is discouraged by the ASX (Australian Stock Exchange).
    - Paid up capital is the amount of capital already paid.
    - Unpaid capital is the amount of capital owing.
    - Uncalled capital is the capital yet to be called by the company

Companies Limited by Shares

✦ A "company limited by shares " means a company formed on the principle of having the liability of its members limited to the amount (if any) unpaid on the shares respectively held by them: s 9 of CA.[2]
✦ Therefore, if shares are issued as fully paid, their holder has no further obligation to contribute to the debts and liabilities of the company, at lease in relation to those shares.
✦ By contrast, if shares are partly paid shares, their holder's obligation is simply to contribute to the company the amount which they have agreed to pay for them and which remains unpaid.
✦ Companies limited by shares may be incorporated either as a proprietary or public company: s 112(1) of the CA.
✦ A company limited by shares must be formed with a share capital.
✦ A company's share capital is the total amount:
  - contributed or promised to be contributed by its members;
  - as proprietors;
  - in money or money's worth;
  - to be adventured in the company's business;
  - on terms that the claim of the contributors to recover their contribution.
✦ A company with limited liability shall have "Limited" or the abbreviation "Ltd" as part of, and at the end of, its name: s 148(2) of the CA.
✦ The company limited by shares is all but exclusively used as a vehicle for trading activity.

Unlimited Companies

✦ An "unlimited company " means a company whose members have no limit placed on their liability: s 9 of the CA.
✦ Thus, an unlimited company differs from other companies in that its members may be made liable in a winding up for its debts without limit on their liability.
✦ An unlimited company can be registered as a proprietary company or as a public company: s 112(1) of the CA.
✦ Members of an unlimited company are not directly liable to creditors of the company.

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[2] Corporations Act 2001 (Cth), s 9.

- Their liability for the company's debts is contingent upon the company being wound up and the assets of the company being inadequate to satisfy its liabilities.
- A creditor who cannot recover from the company must apply to the court for a winding up order if there is to be recovery against the members.
- Members will be called on in the first instance to contribute equally.

✦ Unlimited companies are not normally used by trading ventures.
✦ The name of an unlimited company does not have to end with the word "Unlimited" or with any other word drawing attention to the unlimited liability of the members.
✦ One advantage to have an unlimited company is that since members of an unlimited company bear full responsibility for the company's liabilities, this class of company is exempted from the prohibition upon unsanctioned capital reduction: s 258A of the CA.

Companies Limited by Guarantee

✦ A "company limited by guarantee " means 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 of the CA.
✦ On the winding up of a company limited by guarantee no contribution is required from a member exceeding the amount undertaken to be contributed in the event of winding up: s 517 of the CA.
✦ A company limited by guarantee is in practice employed for non-profit activities.
✦ The feature that distinguishes a company limited by guarantee from a company limited by shares is that a company limited by guarantee does not have power to issue shares: s 124 of the CA.
✦ Since member's guarantees may only be enforced on the winding up of the company, they are not assets of the company which may be charged during its life: Re Pyle Works.[3]
✦ A company limited by guarantee has no share capital. It may require fees to be paid by members or may raise loans but prima facie it is not a convenient vehicle for a business needing working capital.
✦ A company limited by guarantee cannot be a proprietary company and will always be a public company: s 112(1) of the CA.
✦ ASIC is permitted to authorise a guarantee company to dispense with the word "Limited" as part of its name when the constitution of the company requires the company to pursue charitable purposes exclusively and prohibits distributions to members and the payment of fee to directors: s 150 of the CA.

No Liability Companies

✦ A company may be registered as a no liability company only if: s 112(2) of the CA
  (a)the company has a share capital; and
  (b)the company's constitution states that its sole objects are mining purposes; and
  (c)the company has no contractual right under its constitution to recover calls made on its shares from a shareholder who fails to pay them.
✦ "Mining purposes" means prospecting for, obtaining or selling ores, metals or minerals: s 9 of the CA.
✦ A no liability company is required to include the words "No Liability" or "NL" as part of and at the end of its name: s 148(4) of the CA.
✦ A no liability company may only be registered as a public company: s 112(1) of the CA.

Classification Accordingly to Size

Proprietary Companies

✦ A proprietary company is a private company designed for a relatively small group of persons who do not wish the company to be able to invite the public to subscribe for its share capital or to lend money to it.
✦ Only a company limited by shares or an unlimited company may be incorporated as a proprietary company. Both company types must have a share capital.
✦ A no liability company, even though it has share capital, is excluded: s 112 of the CA.

[3] Re Pyle Works (1890) 44 Ch D 534 at 574, 584.

Two prohibitions of a proprietary company

s 113 Proprietary companies

(1) A proprietary company must have no more than 50 non-employee shareholders.

- Proprietary companies are not limited to those where management and ownership are in the same person since a proprietary company can have a maximum number of 50 shareholders.
- Employee-shareholders are not included in this number.
- Thus, a proprietary company may be a well-established family business with some members actively managing and others who are merely passive recipients of dividends; or, at the other extreme, it may be a single-shareholder company.

(3) A proprietary company must not engage in any activity that would require disclosure to investors under Chapter 6D (which deals with fundraising), except for an offer of its shares to:

(a)existing shareholders of the company; or

(b)employees of the company or of a subsidiary of the company.

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(4) An act or transaction is not invalid merely because of a contravention of subsection (3).

✦ Thus, if a proprietary company:
- ceases to be a company limited by shares or an unlimited company with a share capital;
- allows its non-employee shareholders to exceed 50; or
- engages in activity that would require disclosure to investors under Ch 6D.

✓ ASIC can order the company to convert to a public company: s 165 of the CA.

Categories of Proprietary Company

✦ At various times throughout its existence a proprietary company may for a financial year be either a:
- small proprietary company as defined in s 45A(2) of the CA; or
- large proprietary company as defined in s 45A(3) of the CA.

✦ A proprietary company is a small proprietary company for a financial year if it satisfies at least 2 of the followings:
- The consolidated gross operating revenue for the financial year of the company and the entitles it controls (if any) is less than $25 million.
- The value of the consolidated gross assets at the end of the financial year of the company and the entities it controls (if any) is less than $12.5 million.
- The company and the entities it controls (if any) have fewer than 50 employees at the end of the financial year.

✦ A proprietary company is a large proprietary company for a financial year if it satisfies at least 2 of the followings:
- The consolidated gross operating revenue for the financial year of the company and the entities it controls (if any) is $25 million or more.
- The value of the consolidated gross assets at the end of the financial year of the company and the entities it controls (if any) is $12.5 million or more.
- The company and the entities it controls (if any) have 50 or more employees at the end of the financial year.

✦ Privileges confined to small proprietary companies – a small proprietary company is required to prepare financial statements and send them to members only if:
- shareholders with at least 5 percent of votes direct the company to do so: s 293 of the CA.
- the company is controlled by a foreign company and is not included in consolidated accounts lodged with ASIC by the foreign company: s 292 of the CA; or
- ASIC directs it to do so: s 294 of the CA.

Advantages Enjoyed by Proprietary Companies Generally

✦ Any proprietary company may register with a single shareholder and trade with a single director: ss 114(1), 221(1) of the CA.

✦ The requirement to hold an annual general meetings does not apply to proprietary companies: s 250N of the CA.

✦ Resolutions required or permitted to be passed at general meetings may be deemed to have been so passed even though no meeting was held provided all members sign a document stating that they favour a resolution. – but this informal procedure is not available where the resolution is to remove an auditor under s 329: s 249A of the CA.

✦ There is no need for each director to be appointed by a separate resolution when the appointment is by the company in general meeting. (compare s 201E of the CA)

- *There is no entrenched statutory right of members to remove a director. (compare s 203D of the CA)*
- *Directors may be made removable by other directors, if power to do so is given in the constitution. (compare s 203E, CA)*
- *The legislative prohibition in s 195 of the CA on directors voting or being present at consideration of a matter in which they have a material personal interest does not apply to directors of a proprietary company (see s 191 on disclosure of interests).*
- *The regulation of financial benefits to directors and other related entities in Ch 2E does not apply to a proprietary company.*
- *Directors' reports of a proprietary company do not have to contain statements about directors' qualification, their attendance at meetings, their shares or their contracts with the company: s 300(10), CA.*
- *If the company appoints an auditor, the members are not prohibited from appointing:*
  - *an officer of the company;*
  - *a partner, employer or employee of an officer of the company; or*
  - *a partner or employee of an employee of an officer of the company.*

  ✓ *provided that in each case he or she is a registered company auditor and is not otherwise disqualified: s 324, CA.*
- *Resignation of an auditor does not require the consent of ASIC: s 329, CA.*
- *If the company is wound up in a member's voluntary winding up, the person appointed as liquidator need not be a registered liquidator and can be an officer or auditor of the company: s 532, CA.*
- *There is no obligation to appoint a secretary: s 204A, CA.*

Public Companies

- *If a company is not a proprietary company, it is a public company, the residuary class of companies: s 9, CA.*

Identification of a Public Company

- *More than 50 shareholders.*
- *Ltd in the title (but not Pty Ltd).*
- *If the company is listed on the Stock Exchange.*
- *If the company is involved in fundraising activity.*

Directors in Public Company

Minimum number of directors: *s 201A, CA*
(1) Proprietary companies must have at least one director...that director must reside in Australia.
(2) Public companies must have at least three directors...At least 2 directors must reside in Australia.

Who can be a director: *s 201B, CA*
(1) Only an individual who is at least 18 may be appointed as a director of a company.

Powers of directors: *s 198A, CA*
(1) The business of a company is to be managed by or under the direction of the directors.
(2) The directors may exercise all the powers of the company except any powers that this Act or the company's constitution (if any) requires the company to exercise in general meeting.

Classification According to Listing

s 114 Minimum of 1 member
A company needs to have at least 1 member.
s 115 Restrictions on size of partnerships and associations
(1) A person must not participate in the formation of a partnership or association that:
(a)has as an object gain for itself or for any of its members; and
(b)has more than 20 members;
unless the partnership or association is incorporated or formed under an Australian law.
s 116 Trade unions cannot be registered
A trade union cannot be registered under this Act.

Part 1.5: Small Business Guide (Repealed)

This guide summarises the main rules in the Corporations Law that apply to proprietary companies limited by shares-the most common type of company used by small business. The guide gives a general overview of the Corporations Law as it applies to those companies and directs readers to the operative provisions in the Law.

1.1 Separate legal entity that has its own powers

- *... a company has a separate legal existence that is distinct from that of its owners, managers, operators, employees and agents. A company has its own property, its own rights and its own obligations. A company's money and other assets belong to the company and must be used for the company's purposes.*
- *A company has the powers of an individual, including the powers to:*
  - *own and dispose of property and other assets*
  - *enter into contracts*
  - *sue and be sued.*

1.2 Limited liability of shareholders

- *Shareholders of a company are not liable (in their capacity as shareholders) for the company's debts. As shareholders, their only obligation is to pay the company any amount unpaid on their shares if they are called upon to do so.*
- *However, particularly if a shareholder is also a director, this limitation may be affected by other laws and the commercial practices discussed in 1.3 and 1.4.*

1.3 Director's liability for company's debts

- *A director of a company may be liable for debts incurred by the company at a time when the company itself is unable to pay those debts as they fall due.*
- *A director of a company may be liable to compensate the company for any losses the company suffers from a breach of certain of the director's duties to the company.*

1.4 Director's liability as guarantor/security over personal assets

- *As a matter of commercial practice, a bank, trade creditor or anyone else providing finance or credit to a company may ask a director of the company:*
  - *for a personal guarantee of the company's liabilities; and*
  - *for some form of security over their house or personal assets to secure the performance by the company of its obligations.*

1.5 Continued existence

- *A company continues to exist even if 1 or more of its shareholders or directors sells their shares, dies or leaves the company.*
- *If a company has only 1 shareholder who is also the only director of the company and that person dies, their personal representative is able to ensure that the company continues to operate.*

1.7 How a company acts

- *A company does not have a physical existence. It must act through other people.*
- *Individual directors, the company secretary, company employees or agents may be authorised to enter into contracts that bind the company.*
- *In some circumstances, a company will be bound by something done by another person.*

1.9 Shareholders

- *The shareholders of a company own the company, but the company has a separate legal existence and the company's assets belong to the company.*
- *Shareholders can make decisions about the company by passing a resolution, usually at a meeting. A "special resolution" usually involves more important questions affecting the company as a whole or the rights of some or all of its shareholders.*
- *There are 2 ways that shareholders may pass a resolution:*
  - *at a meeting; or*
  - *by having all of the shareholders record and sign their decision.*

1.1.5 Corporate Constitution and Organs

Corporate Constitution

- Prior to 1998, a constitutional document includes a memorandum of association and the articles of association.
  - The memorandum was the incorporating document which contained fundamental matters such as the company's capital structure.
  - The articles of association usually contain detailed provisions relating to the internal organisation of the company, including:
    - the division of corporate powers between the board of directors and the general meeting of shareholders;
    - proceedings of the board and general meetings;
    - the appointment and remuneration of directors;
    - the transfer and transmission of shares;
    - declaration of dividends and
    - the winding up of the company.
- A company may adopt or vary the terms of a constitution by special resolution: s 136(1)-(2), CA.
  - There is scope for entrenchment of a constitutional provision against alternation by a special resolution, by specifying in the constitution a further requirement for its alteration which provision may not itself be repealed unless the further requirement is satisfied: s 136(3)-(4), CA.
  - A special resolution is one passed with the support of at least 75 percent of the vote cast by members entitled to vote on the resolution who have notice of intention to propose the special resolution and of its terms: s 9, CA.
- A public company which adopts a constitution must lodge a copy with ASIC together with a copy of any special resolution altering its provisions: ss 117(3), 136(5), CA.
- A proprietary company which adopts a constitution need not lodge it with ASIC but must send a copy to a member of the company upon request: s 139, CA.

Choice between Corporate Constitution and Replaceable Rules

- Currently, the two kinds of "corporate governance rules" are:
  - those sections of the CA which contain so-called "replaceable rules" which a company may be consent to have, in whole or in part, as its rules or which it may exclude, modify or replace by formulating its own rules; and
  - a document called the "constitution" which the company may adopt to certain rules it has formulated to supplement or to modify or replace the statutory replaceable rules.
- Companies therefore have three options in relation to the choice of rules to govern their internal management:
  - they may elect to function without a constitution, relying solely upon the replaceable rules;
  - the company may adopt its own constitution to displace or modify the replaceable rules wholly or in part: s 136, CA;
  - if it was incorporated prior to 1 July 1998, it may retain its memorandum and articles of association as the constitution of the company to the exclusion of inconsistent replaceable rules; if the company is a public company, those provisions of the Act which contain a mandatory rule for public companies also apply to them: s 135, CA.
- A table of replaceable rules is contained in s141, CA.
- Replaceable rules do not apply to a proprietary company while the same person is both its sole shareholder and sole director.
  - This exclusion is justified on the ground that such a company has little need for a formal set of rules governing its internal relationships.[4]

Reasons not to use the replaceable rules

- Firstly, most companies will find some replaceable rules to be inappropriate – for example, public companies listed on the ASX must have a constitution: ASX LR 15.11.
- Secondly, if the legislature amends a replaceable rule in the CA that amendment will apply to any company to which the rule applies. While amendments by the legislature to replaceable rules are likely to be rare, a company may wish to ensure its retention of control over its rules of internal governance by having its own constitution replacing rules in the CA.
- In addition, the replaceable rules do not deal with every aspect of corporate governance. Some companies will, at least, need to supplement the replaceable rules. For example, the replaceable rules do not cater for a company which wishes to have partly-paid shares. Such a company will need a constitution containing rules about the making of calls and forfeiture.

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[4] Company Law Reform Bill 1997, Explanatory Memorandum, para 8.22.

- Further, a company may wish to bring all rules of corporate governance into one document for the convenience of officers and members.
- Finally, another possible reason for a company not wanting to be governed by any replaceable rule could be a desire to avoid any suggestion that decision made under any such rule could be decision made "under an enactment" and so be reviewable under the ADJR Act.
- The company's constitution and any replaceable rules that apply to it have effect as a contract between: s 140, CA.
  - the company and each member;
  - the company and each director and secretary; and
  - the members themselves.

Corporate Organs

- Historically, two groups of individuals have been recognised as having authority to act for the corporation:
  - its members assembled in general meeting; and
  - its board of directors or governing committee

1.1.6 Corporate Groups

- The term "corporate group" refers to 'a number of companies which are associated by common or interlocking shareholdings, allied to unified control or capacity to control": Walker v Wimborne.[5]
- There are two competing legal conceptions of the group:
  - as a family or subsidiary companies under a holding company which has majority ownership or voting control of the subsidiary companies; – being the related company
  - as an economic entity of a parent and its controlled entities under a broader and more generally expressed definition of corporate control. – being the controlled entity.

Reasons For Having Corporate Groups

- As the consequence of company takeovers following the acquisition of all or a majority of the shares of another company; taxation and stamp duty law favour this mode of acquisition over the purchase of the assets of the acquired business;
- To achieve organisational efficiencies by segregating different business or functions into separate companies;
- To maximise the benefits of limited liability by isolating the risk of business failure in a single entity; and
- In the case of partly owned subsidiaries, to obtain control of another entity and access to its resources without the cost of acquiring all of its share capital.

Subsidiary Company

Corporations Act 2001 (Cth)
PART 1.2----INTERPRETATION
Division 6--Subsidiaries and related bodies corporate

> **s 46 What is a subsidiary**
> (a) A subsidiary company is one in which another company
> (i) controls the composition of the board; or
> (ii)is in a position to cast, or control the casting of, more than half of the votes in a general meeting; or
> (iii)holds more than half of the share capital.
> (b) A company will be a subsidiary of another if it is a subsidiary of a subsidiary of that other.

- The notion of control of voting and board composition in the definition of a subsidiary was inherently uncertain by the mid 1990s.
- Now the term "in a position to cast" is interpreted widely: Bluebird Investments v Graf. In that case, a 22 percent shareholding might in the circumstances satisfy the test in s 46(a)(ii), viz, the holder is in a position to cast, or control the casting of, more than half of the votes in a general meeting.

[5] Walker v Wimborne (1976)

- *" In short, an actual power, revocable or not, legally enforceable or not, to cast more than 50% of the votes does suffice to satisfy the "present ability" alternative, so long as it does not depend on further action of support and is not under the control of another person."*

Wholly-owned Subsidiary

- *Where the holding company owns the whole of the share capital of the subsidiary (either directly or through nominees or subsidiaries with no outside interests), it is called a wholly-owned subsidiary: s 9, CA.*
- *Thus, a member of such wholly-owned subsidiary can only be either of the followings: s 9, CA.*
  - *a person of the holding company; or*
  - *a nominee of the holding company; or*
  - *a person of another wholly-owned subsidiary of the holding company; or*
  - *a nominee of another wholly-owned subsidiary of the holding company.*

Holding Company

- *A corporation is a holding company when...the corporation owns or controls a subsidiary [i.e. in relation to a body corporate, means a body corporate of which the first body corporate is a subsidiary]: s 9, CA.*

Related Bodies Corporate

- *Corporate bodies are considered to be related where: s 50, CA*
  - *(a) a body corporate is a holding company of another body corporate (a subsidiary); or*
  - *(b) a body corporate is a subsidiary of another body corporate (holding company); or*
  - *(c) a body corporate is a subsidiary of a holding company of another body corporate (i.e. subsidiaries of the same holding company are related)*

Notion of Control

> ***s 50 Control***
> *(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.*

1.2 Administration of Australian Companies

Australian Structures of Corporate Regulation

- *The Commonwealth corporate legislation applies to referring States on the basis of the combined effect of the Commonwealth's legislative powers under the Constitution, s 51 (other than s 51(xxxvii)) and those powers that arise from the State referrals: s 3(1), CA.*
- *The Commonwealth corporate legislation applies in the Australian Capital Territory and the Northern Territory on the basis solely of the Commonwealth's Territories power under the Constitution, s 122, and its legislative power under s 51: s 3(2), CA.*
- *If a State ceases to refer legislative power to the Commonwealth (either by the operation of the sunset clause or prior termination of the referral), the Commonwealth legislation would then apply in the State on the basis of the Commonwealth's other legislative powers including that arising from the referral of powers by other States: s 3(4), CA; s 4(1), ASICA.*[6]
- *Since the Federal Court does not exercise criminal jurisdiction, separate provisions apply for civil and criminal jurisdiction.*
  - *Jurisdiction to determine civil matters arising under the corporations legislation is vested in the Federal Court, in the Supreme Court of each State and Territory and, in relation to ancillary corporations matters arising in family proceedings, the Family Court of Australia: ss 1337B, 1337C, CA.*

[6] *Australian Securities and Investments Commission Act 2001 (Cth).*

- As regards criminal jurisdiction, the several courts of the States and Territories exercising jurisdiction with respect to the summary conviction of offenders have equivalent jurisdiction with respect to offences against the corporations legislation: s 1338B(1).

The Australian Securities and Investments Commission (ASIC)

- Australian companies are administered by ASIC (Australian Securities and Investment Commission). The functions of ASIC include:
  - Regulation of securities and futures markets;
  - Regulation of company takeovers ;
  - Investigative powers to ensure compliance with Corporations Law;
  - Can bring legal proceedings for misconduct as well as intervene in existing proceedings;
  - Education function – policy statements, practice notes, press releases;
  - Works with ASX on certain matters.
- Trustees, auditors, receivers and liquidators have an obligation to report irregularities to ASIC.
- Subject to the ASIC Act, ASIC has the general administration of this Act: s 5B, CA.

The Australian Securities Exchange (ASX)

- Created in 1985 when 6 capital city stock exchanges merged to form the ASX to conduct a single national stock exchange;
- Principle securities exchange operating in Australia
- In 1998, it became a public company limited by shares i.e. a company conducted as an ordinary commercial enterprise to earn profits for distribution as dividends to shareholders;
- ASX was simultaneously admitted to its own Official List so that shares in ASX might be purchased and traded upon the stock market conducted by ASX itself.

1.3 Why Form a Company?

Prohibition in the Corporations Act

- s 115 prohibits the formation with more than 20 members of a partnership or association having for its object the acquisition of gain by the association or individual members.
- Exceptions: Corporations Regulations (reg 2A.1.01)
  - medical practitioners (50 members);
  - legal practitioners (400 members) and
  - accountants (1000 members).

Pros and Cons of Incorporation

Limited Liability

Advantages of Incorporation

- Limit participants' liability for the obligations of the enterprise.
- Insulate members' other assets from claims against the company and protects against potentially crippling losses which may not always be avoided through insurance.
- Essentially a risk-shifting device

Disadvantages of Incorporation

- Potential for abuse leading to disadvantages for particular groups (such as tort claimants). – Limited liability can be abused in corporate groups (risky businesses with few assets may be allocated to an undercapitalised subsidiary).

Commercial Reality

- Banks dealing with small closely held corporations often require personal guarantees from directors/major shareholders before extending credit but there is still insulation from liability to trade creditors or tort creditors.

Perpetual Succession

- The company enjoys perpetual succession since it is invested with the legal capacity and powers of an individual with none of the frailties that flesh is heir to - i..e status of company is unaffected by death or bankruptcy of members or by transfer of ownership.
- By contrast, such events will automatically dissolve a partnership.

Financing

- Unincorporated forms of business organisation are denied the corporate advantages of the power to create a floating security over its assets or to make a public issue of its shares or debt interests (debentures).
- It is a security interest which "floats" over the subject property, allowing the company to deal with and dispose of the property in the ordinary course of business until some defined act of default.

Cost, Formality and Continuing Obligations

Partnership

- Partnership is a remarkably flexible business form. No formality is required for its creation. Internal structure is not constrained by statute and no registration or reporting obligations are imposed.
- Partners may freely withdraw their capital form the firm which may be dissolved without formality.

Incorporation

- Incorporation is an act of the state, attended with formality and expense.
- The Corporations Act imposes continuing obligations to disclose information for the benefit of creditors, members and, in some cases, the wider community.
- The corporation is a stable form of business (shareholders cannot simply dissolve corporations at will).

Taxation

- The dividend imputation provisions introduced in the 1980s eliminate the double taxation of company dividends - certain advantages for deductions over those trading in unincorporated form.

1.4 How Do You Form a Company?

Incorporation of a Company under the Act

Corporations Act 2001 (Cth)
CHAPTER 2A--Registering a company
PART 2A.2----HOW A COMPANY IS REGISTERED

s 117 Applying for registration
Lodging application...
(1) To register a company, a person must lodge an application with ASIC.
Contents of the application...
(2) The application must state the following...

- the type of company that is proposed to be registered;
- its proposed name, unless it is intended that its name will simply be 'Australian Company Number' or 'ACN' followed by the number assigned by ASIC upon registration;
- the names and addresses of persons who consent to be members, directors or secretary of the company;
- its proposed registered office and, if it is different, its proposed principal place of business; and details of its proposed share capital or guarantee obligation, as applicable.

s 118 ASIC gives company ACN, registers company and issues certificate

(1) If an application is lodged under section 117, ASIC may:

(a) give the company an ACN; and

(b) register the company; and

s 119 Company comes into existence on registration

A company comes into existence as a body corporate at the beginning of the day on which it is registered. The company's name is the name specified in the certificate of registration.

Note: The company remains in existence until it is deregistered (see Chapter 5A).

s 120 Members, directors and company secretary of a company

(1) A person becomes a member, director or company secretary of a company on registration if the person is specified in the application with their consent as a proposed member, director or company secretary of the company.

s 121 Registered office

The address specified in the application for registration for the company's proposed registered office becomes the address of the company's registered office on registration.

s 122 Expenses incurred in promoting and setting up company

The expenses incurred before registration in promoting and setting up a company may be paid out of the company's assets.

s 123 Company may have common seal

(1) A company may have a common seal. If a company does have a common seal, the company must set out on it:

(a) for a company that has its ACN in its name–the company's name; or

(b) otherwise - the company's name and either:

(i) the expression "Australian Company Number" and the company's ACN; or

(ii) if the last 9 digits of the company's ABN are the same, and in the same order, as the last 9 digits of its ACN– the expression "Australian Business Number" and the company's ABN.

s 601AD Effect of deregistration

(1) A company ceases to exist on deregistration.

s 124 Legal capacity and powers of a company

(1) From registration, the company has the legal capacity and powers of an individual (viz, natural persons) together with the distinctive powers of a body corporate, for example, to issue shares or grant a floating charge.

s 148 A company's name

(2) A limited company is required to include "Limited" or "Ltd" at the end of its name; a proprietary limited company must have "Proprietary Limited" or "Pty Ltd" at the end of its name.

Shelf Companies

- The incorporation of a company may take several weeks.
- In consequence, a widespread practice has developed, particularly in small business, of using shelf companies which are incorporated in advance of need, and activated when instructions are received to form a company.

2.1 The Doctrine of Corporate Personality

- Corporate personality is a human construct, created to solve human problems.
- When it is applied, the business corporation was invested with an entity status, a personhood, distinct from that of its member.
- This sets the registered company and other corporations apart from unincorporated forms of business association such as the partnership.
- Arguably also, it has the consequence of distancing shareholders from the enterprise and weakening their responsibility for its affairs.
- In modern business, corporate personality serves the function of marking out an asset pool against which creditors of the enterprise have prior claim. – Entity status partitions this asset pool from the personal assets of stakeholders.

Corporations Act 2001 (Cth)
CHAPTER 2B--Basic features of a company
PART 2B.1----COMPANY POWERS AND HOW THEY ARE EXERCISED

s 124 Legal capacity and powers of a company

(1) A company has the legal capacity and powers of an individual both in and outside this jurisdiction.
- i.e. can commit crimes and torts..can sue and be sued...can acquire and dispose of property...bring an action for defamation.

A company also has all the 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).

s 125 Constitution may limit powers and set out objects

(1) If a company has a constitution, it may contain an express restriction on, or a prohibition of, the company's exercise of any of its powers. The exercise of a power by the company is not invalid merely because it is contrary to an express restriction or prohibition in the company's constitution.

(2) If a company has a constitution, it may set out the company's objects. An act of the company is not invalid merely because it is contrary to or beyond any objects in the company's constitution.

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

- Public company:
  - Minimum 3 directors;
  - 2 of 3 must be residents.
- Proprietary company:
  - Minimum 1 directors, and
  - Must be resident.

s 112 Types of companies
s 114 Minimum of 1 member
s 119 Company comes into existence on registration
s 201A Minimum number of directors

2.2 Concepts of Separate Corporate Personality and Limited Liability

- While a company registered under the Act is invested with the legal capacity and powers of an individual: s 124, CA, its incorporeal nature ensures that it enjoys perpetual succession in the sense that there is no temporal limit upon its existence, which existence is unaffected by changes to its members.
- Further, though a corporation is soulless, it may commit both crime and tort; injury to the corporation reputation may be assuaged by an action for defamation: New South Wales Aboriginal Land Council v Jones (1998); and the corporation may be in contempt of court: R v J G Hammond & Co [1914].
- The general interpretation statutes of the Commonwealth and the States declare that a reference in legislation to a "person" includes a reference to a body corporate, subject only to a contrary intention appearing in a particular statute: s 22, Acts Interpretation Act 1901 (Cth).
- But "residents" in s 75(iv) of the Commonwealth Constitution (for purpose of conferring jurisdiction in disputes between residents of different States) does not embrace corporations: Australian Temperance and General Life Assurance Society Ltd v Howe (1922).
- Similarity, a corporation will be denied that status of "a subject of the Queen" for the purpose of s 117 of the Constitution since they are incapable of personal allegiance: C L Pannam (1967) 6 MULR 105 at 140.

The Separate Entity Doctrine (Corporate Personality)

- The separate entity doctrine means "for certain purposes a company is a legal entity separate from the legal persons who became associated for its formation or who are now its members and its directors.
- Therefore, to say that a company is a separate legal entity means that the company can have legal rights, privileges, duties or liabilities without them being rights, privileges, duties or liabilities of its members or directors.
- A company is a legal fiction but it is not a sham. A company will be seen to be a sham only when the conditions for that conventional acceptance are not fulfilled.
- However, it should be mentioned the separate entity doctrine does not mean that a company is separate from its directors or members in every respect.
  - When it is the board of directors that acts on behalf of the company there is a fiction that the company itself is acting, the board of directors being considered to be an organ of the company rather than merely being its agent.
  - When the person acting on behalf of the company is authorised by the board of directors to act for the company that person does so as an agent of the company.
- Consequence of the separate entity doctrine:
  - The separate entity doctrine does not itself import limited liability.
  - But the formation of the company as a separate entity capable of acquiring obligations separate from those of its members makes it possible for society to give members the privilege of limited liability on contracts advancing their interests.

Salomon v Salomon & Co Ltd [1897] AC 22

1. Mr Aron Salomon made leather boots and shoes in a large Whitechapel High Street establishment. His sons wanted to become business partners, so he turned the business into a limited company. The company purchased Salomon's business for £39,000, which was an excessive price for its value. His wife and five eldest children became subscribers and two eldest sons also directors (but as nominee for Salomon, making it a one-man business). Mr Salomon took 20,001 of the company's 20,007 shares. Transfer of the business took place on June 1, 1892. The company also gave Mr Salomon £10,000 in debentures (i.e., Salomon gave the company a £10,000 loan, secured by a floating charge over the assets of the company). On the security of his debentures, Mr Salomon received an advance of £5,000 from Edmund Broderip.
2. Soon after Mr Salomon incorporated his business a decline in boot sales, exacerbated by a series of strikes which led the Government, Salomon's main customer, to split its contracts among more firms to avoid the risk of its few suppliers being crippled by strikes. Salomon's business failed, defaulting on its interest payments on the debentures (half held by Broderip). Broderip sued to enforce his security in October 1893. The company was put into liquidation. Broderip was repaid his £5,000. This left £1,055 company assets remaining, of which Salomon claimed under his retained debentures. This would leave nothing for the unsecured creditors, of which £7,773 was owing.
3. When the company failed, the company's liquidator contended that the floating charge should not be honoured, and Salomon should be made responsible for the company's debts. Salomon sued.
4. The liquidator, on behalf of the company, counter-claimed wanting the amounts paid to Salomon paid back, and his debentures cancelled. He argued that Salomon had breached his fiduciary duty for selling his business for an excessive price. He also argued the formation of the company in this was fraud against its unsecured creditors.

Held, against the liquidator. It held that the company had conducted the business in its own right for itself beneficially and neither as agent nor trustee: it was not just an alias for Salomon. The seven persons required for the formation of a company did not have to be independent of each other. Salomon was not liable to the indemnify the company. Hence the debt for which security had been given to Salomon could rank before unsecured debts in the distribution of the company's assets.

Two Issues:

- Can Salomon get whatever is left in the corporation to pay out his debentures? Basically does he have priority as a secured creditor over unsecured trade creditors (i.e. suppliers)?
- Is Salomon personally liable for the unpaid debts to the unsecured creditors or is his liability limited?

Held in the lower courts

- On priority at trial and the Court of Appeal:
  - Salomon could not have priority for his debentures on the basis that sale to himself was a fraud.
- On liability issue at trial:
  - Salomon was personally liable because the company was the mere "nominee and agent" of Salomon. A principle must reimburse and indemnify the agent for its costs.
- On liability issue in the Court of Appeal: Not a relationship of agency, but the corporation was acting as trustee for Salomon and so Salomon had to be liable. They argued the six dummies as subscribers subverted the Act.

Held per the House of Lords per Macnaghten LJ:

- On priority:

- *Salomon could have priority, there was not enough evidence to show fraud – it was the fault of the unsecured creditors for not checking that there were debentures in Salomon's favour which would have priority on bankruptcy (but note, at the time of the case, they needn't have been registered to be valid).*

- *On liability issue:*
  - *The Act only required 7 shareholders for a company to be validly constituted. The lower courts were wrong in arguing that the Act required independent shareholders with some substantive role in running the company. That would be adding to the statute. This is a formalistic approach to legislative interpretation.*
- *In response to the agency/trustee argument:*
  - *It is inconsistent to think the corporation is a sham but can still occupy such positions. Importantly, the mere fact that a single shareholder has dominance (or even complete control) does not mean that the shareholder is acting as an agent or is its beneficiary.*

- *Separate entity doctrine*
  - *The sole guide must be the statute itself...the statute enacts nothing as to the extent or degree of interest which may be held by each of the seven, or as to the proportion of interest or influence possessed by one or the majority of the shareholders over the others. One share is enough....a body corporate made capable by statute does not lose its individuality by issuing the bulk of its capital to one person... (Lord Halsbury)*
  - *Once a company was legally incorporated, it had to be treated like any other independent person with rights and liabilities of its own and the motives of those who took part in the promotion of the company were irrelevant.*
  - *Therefore, the corporation is at law a separate person from its shareholders...the members are not liable for its debts and liabilities...(Lord Macnaghten)*
- *Fraud and agency*
  - *Nothing was wrong with Mr. Salomon taking advantage of the provisions set out in the statute, as he was perfectly legitimately entitled to do. It was not the function of judges to read limitations into a statute on the basis of their own personal view that, if the laws of the land allowed such a thing. (Lord Macnaghten)*
  - *The fraud seems to consist in the alleged exorbitance of the price and the fact that there was no independent board of directors with whom Salomon could contract (i.e. Salomon fixed the price at which he sold the business to the company). However: (Lord Macnaghten)*
    - *In the first place, the directors did just what they were authorised to do by the memorandum of association. There was no fraud or misrepresentation, and there was nobody deceived.*
    - *In the second place, the company have put it out of their power to restore the property which was transferred to them. It was said that the assets were sold by an order made in the presence of Mr. Salomon, though not with his consent, which declared that the sale was to be without prejudice to the rights claimed by the company by their counter-claim.*
- *When will agency be made out?*
  - *There is some cases which suggest that it may be established where there is no legitimate business purpose for the incorporation. Saul Fridman suggests it may also be possible where an owner is treating the company as an extension of himself, treating the firms assets as his own. However, it is not an easy argument to try to establish agency and the Salomon principle is highly regarded by Australian courts.*

- *No requirement that members be independent.*
- *No requirement of substantial capital. -- the present case fostered the development of the "two-dollar company".*
- *No reason why the benefit of the limited liability should be reserved only to groups of persons.*
- *Separate entity doctrine:*
  - *Rights privileges, duties and liabilities ascribed by law to the company are not ordinarily ascribed to its directors or members by reason of their being directors or members.*
  - *Unfairness alone cannot justify a court departing from the separate entity doctrine.*
- *Doctrine of unanimous assent*
  - *A company is bound in a matter intra vires by the unanimous agreement of all its members. (Lord Davey)*
- *Even where the company has only one member in a position to exercise complete control over it, whether it be a company controlled by a sole individual shareholder or a wholly-owned subsidiary company controlled by a parent company, 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.*

1. Lee formed a company to carry on a business of aerial top-dressing. Lee held the whole of the issued capital in the company except for one share held by his solicitor. Lee was appointed governing director of the company and employed at a salary as its chief pilot. By virtue of his powers as governing director and controlling shareholder, Lee enjoyed full and unrestricted control over the affairs of the company.
2. Two years later Lee was killed while carrying out aerial top- dressing work for the company. Pursuant to statutory obligation, the company had taken out workers' compensation to cover on its employees. Lee's widow sued the company for compensation as the widow of a 'worker', defined in the statute as 'a person who works under a contract of service...with an employer'. The NZCA rejected the claim on the basis that, since Lee was the governing director, in whom the full government and control of the company was vested, he could not also be its servant.

Held by Privy Council
the decision of Court of Appeal was reversed.

Lee v Lee's Air Farming Ltd [1961] AC 12

Lord Morris:

- The Privy Council reversed the decision made by Court of Appeal because under Salomon's case, Lee could act in two capacities: as the organ of the company and as an employee.
- It was also possible for him to bind himself by contract to serve the company for a term.
- This is because the relationship came about because the deceased as one legal person was willing to work for and to make a contract with the company which was another legal entity.
- A contractual relationship could only exist on the basis that there was consensus between two contracting parties.
- The mere fact that someone is a director of a company is no impediment to his entering into a contract to serve the company.
- Thus, the capacity of the company to make a contract with the deceased could not be impugned merely because the deceased was the agent of the company in its negotiation.
- It was a logical consequence of the decision in Salomon's case that one person may function in dual capacities.
- Therefore, the circumstance that in his capacity as a shareholder he could control the course of events would not in itself affect the validity of his contractual relationship with the company.
- Accordingly, the fact that so long as the deceased continued to be governing director, with amplitude of powers, it would be for him to act as the agent of the company to give the orders does not alter the fact that the company and the deceased were two separate and distinct legal persons.
- As a consequence, if the deceased had a contract of service with the company then the company had a right of control.

- Key principle: a company can contract with its controlling member.
- Therefore, it is possible for a controlling member to bind himself by contract to serve the company for a term.
- If during that term he ceased to be controller of the company, he would as employee be subject to the direction of new controllers.
- The fact that as controlling shareholder, he could control the course of events did not affect the validity of the contract between the company, a separate entity, and himself.
- Accordingly, the case could suggest that where the parties are a corporation and its controller, and the two parties share the same mind, consensus can be arrived at without going through the ordinary pre-contract processes of negotiation leading to consensus.

2.3 Piercing the veil of incorporation

- It is often said that where the court looks behind the corporate entity to ascribe a corporate right, privilege, duty or liability to a director or member the court is piercing or lifting the "corporate veil".
- What really happens is that the existence of the company is accepted but instead of the company remaining opaque it is made transparent so that in a proper case the person behind it can be seen as the person to whom the corporate right, privilege, duty or liability can be ascribed.
- But, following points must be noted:
  - Although courts cannot ordinarily treat a company as an agent for its controller: Saloman's case, if a controller not only controls a company, but fails to give it the resources needed to perform its functions, the company might be held to be an agent for the controller.
  - Unfairness alone cannot justify a court departing from the separate entity doctrine: Saloman's case.
- Grounds to depart from the separate entity doctrine (common law):
  - Fraud or improper conduct: Gilford Motor v Horne [1933]
  - Agency;
  - Corporate Groups
  - Other categories
  - General Principle

2.3.1 At Common Law

- Generally speaking, there is no settled principle for piercing the corporate veil: Briggs v James Hardie (1989).
- 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 (1989).
  - Therefore, "a company formed for an unlawful purpose can be refrained from implementing that purpose" by way of piercing the corporate veil: Gilford Motor v Horne [1933]; Jones v Lipman [1962].
  - In a case where a company is the ostensible executor of some function but, not having been provided by its controller with resources necessary to do so as an independent entity, relies on the resources of its controller, the controller is liable to be treated as the true executor of the function: Smith Stone & Knight case. -- elements of agency:
    - Were the profits of the business treated treated as profits of the parent?
    - 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?
  - With respect to corporate group, absent 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 (1977). But it is possible that the veil may be pierced so that the parent company may be responsible for the debts and liabilities of subsidiaries within the corporate group.This occurred in DHN Food Distributors case, related considerations includes:
    - wholly owned subsidiary: DHN Food Distributors.
    - no separate business operations: DHN Food Distributors.
    - nature of the question involved relevant? For example, whether the owner of the business have been disturbed: DHN Food Distributors.
    - But there is still a tension between the legal treatment of corporate group and the commercial realities: Qintex Australia Finance v Schroders (1990).
- In a tortious claim based on negligence against agency or corporate groups, the corporate veil may be pierced if the parent dominated the subsidiary to the point that it had no separate existence or, alternatively, the subsidiary was formed for the purpose of circumventing the law: Briggs v James Hardie (1989).
- Alternatives for lifting the corporate veil -- other possible mechanisms:
  - Duty of care owned by parent directly to employees of the subsidiary, rather than having indirect liability through piercing the corporate veil: CSR v Wren (1997).
  - Vicarious liability -- i.e., where parent company appoints an employee as a nominee director to the board of its subsidiary: Dairy Containers Ltd v NZI Bank Ltd [1995].
  - Shadow directorship: Standard Chartered Bank of Australia v Antico (No 2) (1995) -- i.e., a person in accordance with whose instructions or wishes the directors of the company are accustomed to act:"director" in s 9(b)(ii).
  - De facto directorship: Grimaldi v Chameleon Mining NL (No 2) [2012] -- i.e., a person who acts in the position of a director in s 9(b)(i).
  - Insolvent trading: s 588G, CA.

Fraud or Improper Conduct

✦ The general principle is that "a company formed for an unlawful purpose can be refrained from implementing that purpose" by way of piercing the corporate veil: Gilford Motor v Horne [1933]; Jones v Lipman [1962].

Gilford Motor Co Ltd v Horne [1933] 1 Ch 935

1. Horne had covenanted as part of his service agreement as managing director of the Gilford Motor company that he would not at any time solicit customers of G company.
2. Following the ending of that employment, Horne opened a business under his own name which competed with G company.
3. After his solicitor obtained a copy of his service agreement from his former employer a company was incorporated bearing the name of Horne's wife.The business was then conducted by the company.The only shareholders were Horne's wife and a business associate of Horne. H alone conducted the company's affairs.
4. G company sought remedies to restrain not only Horne but also the company from soliciting G company's customers either directly or indirectly.

Held,
an injunction was granted.

- There was unrebutted evidence that one of the reasons for the creation of the company was the fear of Horne that he might commit breaches of the covenant.
- There are references in the judgments to the company being a sham.
  - I am quite satisfied that this company was formed as a device, a stratagem, in order to mask the effective carrying on of a business of Mr E B Horne.