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# (1) The Company - Incorporation and corporate personality

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## The Corporate Structure:

- A Company is a distinct entity from shareholders and directors. Directors and shareholders have distinct powers within the company. They cannot control each other's exercise of powers except through altering their articles - refusing to reelect directors.
- **S128 Management of company**
- **R v Moses:**
  - o "Directors direct; managers manage"
- **S130 Delegation of powers** = the board may delegate powers (individual directors or employee)
- **S109 Management review by shareholders**
  - o Shareholders must be given a reasonable opportunity to reason, discuss the board's decisions
  - o Exception where don't have absolute power. S129 Major Transactions - (1/2 of company's assets) need special resolution by shareholders.

*Internal Rules = the constitution, shareholder agreements (private contracts), listing rules (public company need to comply with - need for independent directors; they can give independent advice to the board to make decisions. Also specialist sub-committees. Stock exchange listing rules.)*

## The Consequences of incorporation:

- **S15 Separate legal personality**
- **Salomon v Salomon & Co Ltd:**
  - o Early 1700's - key case for company law. HOL - use the company format to separate business debts of one-person business from the shareholder's personal assets - acceptable for incorporation.
  - o In business as a sole trader, leather merchant and boot manufacturer. He decided to incorporate a company, Salomon and Co Limited. 7 shareholders comprised of family members all with one share each. Selling company for 40,000 pounds in return company would give him 30,000. Uses 9,000 to pay business debts, 20,000 used to subscribe for more shares, He would lend the company this money and it would be secured by a 'debenture of 10,000 cash'.
  - o Salomon is both shareholder, managing director and vendor - selling the business to his company AND secured creditor. Company fell on hard times, he assigns part of the security (5,000) to Broderip and uses this money to put back into the company. Eventually company issues new debenture (Security) to Mr Broderip for the 5,000. Company put into liquidation: Mr B recovers 5,000, Mr S recovers 1,050, Unsecured creditors and shareholders get nothing.
  - o As a sole trader Mr S would have been personally liable for all his debts and would have been made bankrupt. Yet here loss is taken through unsecured creditors.
  - o COA: concluded company was a legitimate legal entity. Yet bc of Mr S' dominant shareholding, company was an agent for carrying out business for Mr S, thus should be personally liable for all the debts. The court did not like the scheme idea - assumed the company's act requires independent shareholders to beneficially own their shares.
  - o HOL:

- 1) Mr S charged too much:
    - At the time people were selling companies at inflated prices. Key case: **Erlanger v New Somberey**: “People who purchase property and then create a company to purchase the company from them are fiduciaries towards the company and must faithfully state to the company facts which apply to the company”.
    - Court concludes there has been disclosure, once incorporated all the shareholders had known and ratified the sale of the business for 40,000.
  - 2) Whether S was a distinct legal entity:
    - Company did comply with statutory requirements: min number of directors and certificate of incorporation etc.
    - Lord Halsbury: confirms it is legitimate to incorporate company to protect yourself... “motives of those who took part in the promotion of the company are absolutely irrelevant”.
    - Six shareholders were “dummies” - doesn’t matter if they were holding shares on trust
    - Company acting as agent bc he is the dominant shareholder - a company is not in law the agent of the subscribers of the trustee for them.
  - 3) Scam to misled creditors:
    - “any person who holds a predominant share in the stock of a limited company has necessarily the intention of taking the lion’s share of its profits”
    - Lord Watson: the unpaid creditors of the company have duties of making inquiries (all recorded in the company’s office).
- Significance: confirms that Ltd = available for all, even a one-person business. Confirms the company is legally distinct from the shareholder. Case accepts that sometimes courts will look beyond incorporation to say It is a sham?
- **S301 Power of Court to require persons to repay money or return property**
  - **S16 Capacity and powers**
  - **Lee v Lee’s Air Farming Ltd:**
    - Predominant shareholder, his solicitor had one share (bc in those days you needed two shares); hold on trust for Mr Lee. One-person company. All the power of company was vested into Mr Lee so he was governing director. Chief pilot was Mr Lee, terrible accident and he is now deceased. The issue is whether his widow could get compensation after his death - predated the ACC Scheme. The issue was whether Mr Lee was an employee of the company or whether he was an independent contractor - if he was an employee it would be covered by insurance the company has to take out for employees. The legal argument was whether it was legally possible to be both a governing director of the company and an employee of the company.
    - COA held they could only be mutually exclusive. He was company - how can he order himself as an employee?
    - PC said he can act in dual capacities. Distinct legal persons. No reason why he can’t be employed by the company as the agent of the company.
    - Conflict of interest with self-interested transactions. Two different capacities. In what capacity am I acting?
  - **Trevor Ivory v Anderson:**
    - Controversial case - one-person company. Company in business as spraying contractors and chemical advice. Not sure of Trevor’s capacity (agent or employee) but he gave negligent advice to the Andersons. Does Trevor assume any personal liability in giving that advice?

- Orthodox approach would suggest he is liable and the company is vicariously liable
- COA concluded otherwise - when he gave that advice, he did not assume any personal responsibility for that advice. Only the company he would have assumed liability. It would undermine corporate form if imposing personal liability upon him.
- "when it comes to assumption of responsibility, I do not accept that a company director of a one-man company is to be regarded as automatically accepting tort responsibility for giving advice."
- Did he go for the expertise of the company or of him individually? - all depend of facts of individual cases.
- **Dicks v Hobson Swan Construction Ltd:**
  - Different conclusion - different tort. Leaky home, Hobson built the house, companies insolvent and home owner wants to sue the builder. It was the builder personally who did the negligent building work (Mr Dicks). Therefore, he is personal responsible and the company is vicariously liable as well.
- **Mahon v Crockett:**
  - Company, agent, director or employee enters agent on behalf of company then there is a general rule they do not assume personal liability. The contracting party is the company.
- **Macaura v Northern Assurance Co Ltd:**
  - Companies separate personally can be detrimental to shareholder.
  - You have an insurable interest when it affects you - and the law says so.
  - He owns the land and trees and wants to mill the timber, decides to do so through form of a company (The Irish Canadian Saw Mills Ltd).
  - The shareholders are him and his nominees (holdings on trust for him) - one-person company. He has also agreed if the company needs extra money; he would for shares in return. Starts lending the companies money. Mr. Macaura the shareholder and MR Macaura the creditor. The risk here is fire. Better get insurance. He takes out insurance. The timber is the companies. Fire strikes and timber destroyed. Goes to arbitration and the legal issue is: Did Mr M legally have an insurable interest in the timber by Irish Canadian Sawmils Ltd. If he did - the insurance company has to pay out. He should have an insurable interest bc I am both a shareholder and a creditor.
  - HOL says no. Creditor is not a sufficient interest, a secured creditor would have a property right in that interest. Al the creditor owns is the debts and the right to sue the company. No shareholder has a right to any property right in the company. That's not enough to give insurable interest. He had no security over the timber - it was the companies. The debt was no exposed to risk; still owned the shares. His loss arose because the company has no assets.

### Pre- incorporation contracts:

- **S182 Pre-incorporation contracts**
- **S183 Warranties implied in pre-incorporation contracts**
- **Taylor v Todd:**
  - High country farmer Queenstown way - solicitor acting for client purchaser entered into an agreement as "agent for company or companies, and or trust or trusts to be formed". The farm was leasehold and the sale was conditional on freehold process occurring (converted to freehold land). During that time prices had increased quite dramatically. 1999-2003 (ready for settlement). Could sell the farm for much more than what they agreed to in 1999. Solicitor specifies company as purchaser.
  - Is this a pre-incorporation contract - if it is, then the Act allows the company to ratify the contract to be bound by it. The vendors argued bc the company in this case did not satisfy "company in contemplation of incorporation". The court accepted this, the time

in 1999 no one had any ascertainable company in mind. "An agent cannot enter a contract on behalf of a company to be formed to ratify the agreement, unless there is an identified or ascertainable company in mind when the contract is made".

- What does that even mean? They weren't contemplating it would be a company - it could be a trust (from wording at the start).
- **Development Finance Corp NZ v McSherry:**
  - Ratification requires some positive act merely incorporating the company is not enough.
- **Torbay:**
  - Doesn't have to be a formal document to ratify the contract
  - Pre-incorporation to buy some land. The company sold the land to somebody else. The selling ratifies the original agreement.

If acting as an agent, you can opt out of personal liability by stating it in the contract.

## **Registration and Incorporation:**

### **Prerequisites:**

- **S10 Essential Requirements:** company must have: one share, one shareholder, one director
- **S186 and 192** Registered office and address for service (may be different)
- **S12 Application for Registration**

### **The Company Name:**

- **SS20-25**
- **S22 Application for reservation of name**
- **The Paint Factory Limited v The Registrar of Companies:**
  - Names where the difference under consideration are geographical, numerical or date markers, ought not to be regarded as 'almost identical' unless there are other factors about the names which led to that conclusion. On objective impression and analysis, names containing such differences look and sound different from each other".
  - Court is less willing to find names identical
  - Paint Factory Ltd cf The Paint Factory (PN) Limited
  - Much more liberal approach - objective that a normal person would see 1994 is enough to distinguish the two.
  -
- **Protected names**
- **Misuse of another company's name**
  - Passing off
  - Fair Trading Act 1986

### **One Share/on Shareholder:**

- **Issue of shares:** ss41-51
- **Transfer of shares:** ss39,84,87,89

### **Incorporation process:**

- **S13 Registration:** "Registrar must..."
- **Ongoing requirements** - annual returns s214

## The Constitution (ss26-28):

### Adoption:

- At time of registration or later by 'special resolution' s32(2)

### Contents of the constitution:

- Some matters that cannot be altered by the constitution: s 31(1)
  - o solvency test on distribution (s 52)
  - o directors duties (ss 131 - 149) (except 144)
  - o shareholders in same class must be treated equally on distributions (s 53)
- Some matters that may be regulated by the constitution (or Act if constitution silent)
  - o different types of shares may be issued (s 37)
  - o rights and powers attaching to shares (s 36)
  - o percentage for special resolution (s 2 sets lowest %)
  - o restrictions on transferability of shares (s 39)
  - o removal of directors (s 156) *Decade Holdings Ltd v Zeitler* (1998) 8 NZCLC 261,778

### Operation of the constitution:

- SS27, 31(2)
- Enforcement, ss171-172

### Alteration:

- S32
- Statutory fetter on right to alter - s117

## (2)

## Directors

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### Who is a Director?

- **De Jure Director:** validly appointed to be the director, remain eligible
- **De Facto Directors:**
  - o **Re Hydrodam (Corby) Ltd:** "A de facto director... is one who claims to act and purports to act as director, although not validly appointed as such"
- **Shadow Directors:**
  - o **Re Hydrodam (Corby) Ltd:** "A Shadow director ... does not claim or purport to act as a director. On the contrary, he claims not to be a director. He lurks in the shadows, sheltering behind others who, he claims, are the only directors of the company to the exclusion of himself. He is not held out as a director by the company."
- **When is a person a de facto director?**
  - o **Smithton Limited v Naggar:**  
**HMRC v Holland and another [2010] UKSC:**
    - Mr Holland was a director of a company who was a director of another company. The UK has no reason not to let a company be a director of another

company. The last company becomes insolvent. And the liquidators impose liability on the director company who have no assets. So the blame goes to Mr H - he is acting as a director of the insolvent company so we can impose liability on him.

- Fact and degree - take into consideration all relevant factors. Are they making sufficient director type decisions?
  - Key employees, agents or professional advisers - what decisions did they make and did they assume responsibility being director.
  - Whether the person was the sole person directing the affairs of the company, or acting equal footing with the others in directing affairs, whether there was holding out by the company and whether the individual used the title, whether they were part of the “governing corporate structure”.
- **Example of directorial functions referred to in Dairy Containers Ltd. v NZI Bank Ltd.:**
    - The essential picture can be conveyed by summarising the widely-recognised responsibilities of directors put forward by Mr Stannard, a prominent company director called by NZDB. It is the function of directors.
  - **Re UKLI Ltd:**
    - **De Facto director must:**
      1. Presume to act if they were a director
      2. Part of the corporate governing structure - participated in affairs of the company
      3. Substantial or predominant influence in company affairs
      4. Role as if they were a de jure director
      5. Functions performed only undertaken by a director
      6. Whether held out as director
      7. Part of the affairs of the company
      8. Accountable to others - involvement in major decisions
      9. Power to intervene
      10. More than a mere agent
  - **When is a person a shadow director?**
    - Whether the de jure director or board does follow their instructions or directions.
    - **Hydrodam:** (1) who are the directors of the company, whether de facto or de jure; (2) that the defendant directed those directors how to act in relation to the company or that he was one of the persons who did so; (3) that those directors acted in accordance with such directions; and (4) that they were accustomed so to act. What is needed is, first, a board of directors claiming and purporting to act as such; and, secondly, a pattern of behavior in which the board did not exercise any discretion or judgment of its own, but acted in accordance with the directions of others.”
  - **S126 Meaning of “director”**
    - Inclusory - courts can extend if they wish to
    - Various definitions overlap but impose different duties on the people.
  - **(1)(a): Clark v Libra Developments Ltd [169] -[180], Mistmorn Pty Ltd (In Liq) v Yasseen**
    - Courts accepted that a de-jure director disqualified comes within (1)(a).

- (1)(b)(i) & (ii): *Krtolica v Westpac Banking Corporation*,
  - o Land of shadow directors.
  - o *Delegat v Norman* [2012] NZHC 2358 at [28] per Woolford J: “The words ‘accustomed to act’ in s 126(1)(b) suggests some sort of on-going control or influence in a company’s affairs”
- *Australian Securities Commission v A S Nominees Ltd* at 52 per Finn J.
  - o As long as you are giving direction control over somethings - director for those purposes.
  - o Don’t need formal instructions
- *Buzzle Operations Pty Ltd (in liq) v Apple Computer Australia Pty Ltd* at 76 per Young JA
  - o “[I]f a person has a genuine interest of his or her or its own in giving advice to the board, such as a bank or mortgagee, the mere fact that the board will tend to take that advice to preserve it from the mortgagee’s wrath will not make the mortgagee, etc a shadow director.
  - o [T]he vital factor is that the shadow director has the potentiality to control.
- *In re PFTZM Ltd* [1995] BCC 280
  - o
- *Re Tasbin Ltd (No 3)* [1992] BCC 358, CA
  - o Is our accountant a shadow director - monitoring bank accounts and the directors couldn’t spend any money unless the accountants agreed. They are a shadow director.
- *Dairy Containers Ltd v NZI Bank Ltd* [1995] 2 NZLR 30 at 90-91 per Thomas J
  - o “As employees of NZDB I do not doubt that they were accustomed to act in accordance with their employer’s directions or instructions, but as directors of DCL they did not as a matter of fact receive directions or instructions from the parent company. They were, as directors of DCL, standing (or sitting) in the shoes of NZDB at the board table, but they had not and did not receive directions or instructions from their employer. Even when a firm instruction from NZDB was made, it was directed at the company and not at the directors.”
- (1)(b)(iii):
  - o instructing a board rather than an individual person. Act in a certain way.
- *Fatupaito v Bates* [2001] 3 NZLR 386,
  - o Mr B in business as accountant and business advisor. Provides services to new company. Feb 1988: company appears in solvent. Mr B suggest to sole director that Mr B should be appointed as company’s receiver.
  - o Companies can only decide to go into liquidation - cannot appoint a receiver.
  - o MR B could not be given these powers, yet was anyway. Ultimately Mr B had power bc he has sole signing authority of bank account, only one that could access company funds. Cont. trading as company. Financial position of company cont. to deteriorate. 2 duties - not to trade recklessly and .. Breach of these thus personally liable.
  - o Mr B was exercising powers that would normally be decided by the board.
  - o Doesn’t come under b(iii)
- *More to this Life Ltd v Arcadia Homes Ltd (in liq)* [2013] NZCA 286; [2014] 2 NZLR 339
  - o one-person company - signed an agreement for S&P as agent of the company. Company wants to get out of purchase. Brother was director.
  - o COA confirms that 1(b) is just about imposing liability - doesn’t confer any power.
- (1)(c): *Fatupaito v Bates* [2001] 3 NZLR 386