

# DEVELOPMENT OF CORPORATE LAW IN AUSTRALIA AND BUSINESS STRUCTURES

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## 1. The Range of Business Structures

### 1.1 Sole trader

- Sole trader keeps all the profits but also all the liabilities
- Can employ other people – but no perpetual succession

### 1.2 Partnership

- Identifying partnership – distinguishing partnerships from joint ventures
  - Can be written, established or inferred by the surrounding circumstances
  - Partnership Act 1892 (NSW) s 1(1) → Partnership is the relation which exists between persons carrying on a business in common with a view of profit...
    - There is an equivalent Act in other jurisdictions
  - Range of indicia that can indicate partnership:
    - “Regard shall be had to...:
      - Ownership of property;
      - Sharing of gross returns
      - Sharing profits
    - However, these factors must be considered in light of surrounding facts → Courts look to the substance of the relationship
    - E.g. joint registration of business name
    - **Profit sharing alone is not determinative of a partnership**
      - i.e Employees → sharing profits with an employee does not make the employee a partner (Partnership Act s 2 (3)(b))
      - Loans → A creditor taking a share of profits for interest due on loans does not make them a partner (PA s 2(3)(d))
        - Loan **MUST** be in writing to rebut a partnership
  - Joint ventures
    - Two or more parties cooperating with each other to undertake a particular project (eg mining projects, infrastructure, new products etc)
    - Each party contributes special expertise
    - Parties often try to classify commercial relationships as JVs rather than partnerships → to avoid the imposition of fiduciary obligations and the extensive restrictions and liabilities under the Partnership Act
    - However → Court looks to the substance of the relationship

- **Canny Gabriel Castle Jackson Advertising Pty Ltd v Volume Sale (Finance) Pty Ltd [1974] HCA 22**
  - **Facts**
    - 4<sup>th</sup> Media and Volume Sales → in a Joint Venture agreement to promote a concert
    - JV agreement stated:
      - (i) they would share the profits equally;
      - (ii) the JV would be based only on their mutual agreement; and
      - (iii) any disagreements would be settled by arbitration
    - Also gave undertakings re their respective financial stability
  - **Issue**
    - Were 4<sup>th</sup> Media and Volume Sales in a partnership – even though their agreement stated they were in a JV?
    - If so, Canny Gabriel's rights to tickets sales would take second place after Volume Sales' rights as a partner to equal share in \$\$
  - **Held**
    - 4<sup>th</sup> Media and Volume Sales were partners → The **nature** of the obligations showed the business was being conducted with **mutual concern for one another**
    - Looked to the substance of the obligations
- **United Dominions Corp Ltd v Brian Pty Ltd [1985] HCA 49**
  - **Facts**
    - UDC and Brian → members of a property development JV with SPL
    - Prior to forming this JV → UDC and SPL entered into a contract involving the proceeds of the future JV in SPL failed to repay \$\$ lent to it by UDC
    - Brian was unaware of the contract between UDC and SPL
    - During the course of this JV UDC took all of the profits and relied on the previous contract → as SPL had indeed failed to repay \$\$
    - Brian alleged this was a breach of fiduciary relationship between the joint ventures → the JV agreement stated they were JV not partners
  - **Issue**
    - Did a fiduciary relationship exist between UDC and Brian even though they were in a JV?
  - **Held**
    - Partnership not JV despite wording of contract

- Fiduciary relationship between UDC and Brian → Despite wording of the JV agreement → there was a partnership (profit sharing) between the joint ventures
- Ordered UDC to pay Brian its share of the JV profits
- **Re Megevand; Ex parte Delhasse (1878) 7 Ch D 511**
  - **Facts**
    - Merely calling a transactions a “loan” will not prevent the relationship being characterised as a partnership
    - Megevand and his business partner borrowed \$\$\$ from Delhasse
    - Contract stated that the transaction was a loan and Delhasse the rights to:
      - Share in the profits and losses;
      - Receive regular financial statements about the business;
      - Examine the books of the business at any time;
      - Provide further \$\$ to the business if necessary; and
      - Terminate the business at any time
  - **Held**
    - Delhasse was a partner by virtue of the extensive rights the contract gave him which were consistent with those of a partnership than a loan
    - Purpose of the loan → to avoid liability of being partner – but still giving Delhasse all rights and powers that partners usually have
- **Badeley v Consolidated Bank (1888) 38 Ch D 238**
  - **Facts**
    - Agreement to provide funds for building a railway
    - Badeley provided a loan to Smith (railway constructor)
    - Smith assigned his plant machinery etc as security
    - Under the loan agreement Badeley obtained the right to be paid 10% interest and profits
    - Similar facts to Megevand BUT Badeley didn’t have the right to terminate the business → only to take it over if Smith became bankrupt
    - Similar to bank appointing a receiver
    - Badely also didn’t share in the losses of Smith’s business
  - **Held**
    - Genuine loan → NOT a partnership
- **Goudberg v Herniman Associates Pty Ltd [2007] VSCA 12**
  - **Facts**

- Work undertaken by persons who were in the planning stages of setting up an Australian franchise for a large American restaurant chain
  - This work was found to be merely preparatory to carrying on a business
  - The corro between the parties indicated they were working to 'get the project off the ground' and whilst several trips to the United States were undertaken and whilst they were acting in common, and with a view to generating profit
- Principles
  - They were not "carrying on a business"
- Liabilities of partners
  - Partnership Act s 5 → Power of Partner to bind firm
    - (1) Every partner...is an agent of the firm and of the other partners for the purpose of the **business of the partnership**...the acts of every partner who does any act for carrying on in the usual way business of the kind carried on by the firm of which the partner is a member, binds the firm and the other partners, **unless** the partner also acting has in fact no authority to act for the firm in the particular matter, an the person whom the partner is dealing either knows that the partner has no authority or does not know or believe the partner to be a partner"
  - s 6 → Partners bound by acts on behalf of firm
  - s 9 → Liability of partners → Partners jointly liable for debts and obligations incurred whilst they are partners
  - s 10 → Liability of firm for wrongs → "acting in the ordinary course of business of the fir, or with the authority of the partner's co-partners"
  - s 12 → Liability for wrongs joint and several
  - Polkinghorne v Holland [1934] HCA 28
    - Facts
      - Ordinary course of business
      - Mr Holland a partner of a 3 member law firm gave poor investment advice to Ms Polkinghorne a client of the firm
      - He advised her to sell government securities and to invest in a company in which he as involved which had no assets
      - Holland then disappeared with Ms Polkinghorne's \$\$
      - After the investment failed Ms Polkinghorne sued the whole firm of solicitors for compensation for the poor advice she had received
    - Issues
      - Was firm responsible for advice provided by Holland?

- Was the investment advice provided by Holland “in the ordinary course of business”?
- Held
  - Yes the law firm was responsible because Holland had an obligation to advise all clients to seek appropriate financial advice – this obligation occurred in the ordinary course of the law firm’s business
  - Holland failed to fulfil this obligation
- **Dubai Aluminium Co Ltd v Saloom [2002] UKHL 48**
  - Facts
    - A law firm partner had drafted sham contracts to enable a client to improperly obtain substantial commissions from Dubai Aluminium Co Ltd
    - Dubai Aluminium was induced by fraudulent means to pay US \$50m in a series of fake consulting agreements drafted the partner
    - The partner was not authorised by his firm to engage in such conduct
    - Dubai Aluminium sought to make the law firm vicariously liable for the dishonest partner’s actions under the *Partnership Act 1890* (UK)
  - Issues
    - 1) Did the errant partner’s wrongful conduct in drafting the sham contracts occur “in the ordinary course of” the firm’s business?
    - 2) If so, was the firm vicariously liable for the partner’s fraudulent actions?
  - Held
    - The drafting of the agreements was an act done within the ordinary course of the firm’s business (which involved providing legal services) even though they were done for a fraudulent purpose
    - Hence, the partner was acting in the ordinary course of the firm’s business
      - Not “on a frolic of his own”
- **Dubai Aluminium** upheld in Aus/NSW in **Hraiki v Hraiki [2011] NSWSC 656 at [83]-[84]**
- Rights and obligations of partners
  - Relevant Partnership Act provisions
    - S 20 → Partnership property must be held and applied for the benefit of the firm
    - S 29 → Duty of partners to render accounts

- S 30 → Duty of partner not to compete with firm
- **Birtchnell v Equity Trustees Execution & Agency Co Ltd [1929] HCA 24**
  - Facts
    - The Birtchnells sued Equity Trustees, the executors of the estate of Mr Porter – who (before his death) was a partner in their real estate business
    - Birtchnell alleged Porter had received a secret commission from one of their firm's clients in a land sub-division handled by the firm → sought their share of the secret commission as partners of Mr Porter
  - Issues
    - Was Mr Porter's conduct in receiving the secret commission in breach of his fiduciary obligations as a partner of the firm before his death?
  - Held
    - HCA held that Mr Porter's conduct (obtaining a secret commission from a land sub-division) was within the scope of the real estate firm's activities → the real estate firm had occasionally engaged in land development activities
    - Also the scope of a fiduciary's obligation will be determined by the nature of the relationship between the fiduciary and the principal → which may include:
      - (i) any contract; and
      - (ii) the range of activities undertaken by the firm
    - Need not look to the broader context
- **Dean v McDowell (1878) 8 Ch D 345**
  - Facts
    - MacDowell and Dean – Partners in a firm of salt merchants and brokers
    - Partnership agreement provided the business would last seven years
    - Two key clauses:
      - Clause 8 – Required the partners to “diligently and faithfully employ themselves in and about the business of partnership, and carry on and conduct the same to the greatest advantage of the partnership”
      - Clause 11 – Prohibited the partners from engaging “directly or indirectly in any trade or business except upon the account and for the benefit of the partnership”
    - Agreement allowed Dean to engage in “any other trade or business he shall think fit”

- After the partnership has expired → the partners discovered MacDowell had been a partner in a firm of salt manufacturers which had become very profitable
- Issues
  - Could Dean seek an account of profits from McDowell?
- Held
  - Court held the businesses were distinct business and that there was no detriment suffered by the salt merchants
- **Kak Loui Chan v Zacharia [1984] HCA 36**
  - Facts
    - Dr Chan and Dr Zacharia → had been partners in a medical practice
    - The lease on the premises of their surgery was due to expire
    - Option to renew the lease had to be undertaken by both partners
    - After the dissolution but before the winding up of the partnership Chan sought to exclude Zacharia from practicing there by taking up a new lease in his own name alone
      - And hence continuing the medical practice on his own
  - Issues
    - Did Chan breach his fiduciary obligations as a parties?
  - Held
    - Dr Chan had breached his fiduciary duty abusing his fiduciary position as a trustee and former partner to seek an advantage for himself
    - Failed to act with fairness and good faith → Hence accountable to Dr Zacharia for the private profit he gained (**Account of profits**)
    - Fiduciary obligation between partners – may continue even after firm's business has ceased trading
    - Key takeaway is that fiduciary obligations may continue even after the firm's business has ceased trading
- Termination of partnerships
  - Partnerships may be terminated by:
    - Partnerships Act s 32 → Dissolution by expiration or otherwise
      - If entered into for a fixed term, by the expiration of that term
      - If entered into for a single adventure or undertaking, by the termination of that adventure or undertaking
      - If entered into for an undefined time, by any partner giving notice to the other or others of the partner's intention to dissolve the partnership
    - S 33 → Dissolution by bankruptcy, death or change

- S 34 → Dissolution by illegality of partnership
- S 35 → Dissolution by the Court
- Association — Incorporated and unincorporated
- Cooperatives — Autonomous self-help organisations controlled by members for their mutual benefit
- Trusts — equitable relationships where a trustee holds and may manage property for the benefit of beneficiaries

## 2. Rationale for Forming Companies

- Limitations of the business structures discussed above
  - Liability; fundraising; succession
- Why do people form companies?
  - Separate legal personality → limited liability of member
  - Enables investment and business growth → economic growth
  - Enables perpetual succession
- Companies (corporations) – have separate legal personality;
  - May enter into contracts
  - May employ people
  - May raise capital
  - May borrow, lend and invest \$\$
  - May sue and be sued (contract, tort and statutory liability)

## 3. Stakeholders of Companies

- Shareholders ('members')
  - Invest \$\$ (Capital) into companies
  - Receive shares (securities) in company → they therefore have equity in company (right to share in net worth of company)
  - May sell their shares; may receive dividends
  - Can be categorised as:
    - Retail investor → individual investors
    - Institutional → Banks, insurance companies, superannuation funds, governments, fund managers
- Directors
  - Govern companies
    - In small closely-held companies – directors often involved in management
    - In larger companies – Directors delegate management to managers and employees
- Creditors
  - Lend \$\$ to companies – creditors include financial institutions, companies and individuals



- Contractors and business partners
- Employees
- Interest groups
- Increasing prevalence of Corporate Social Responsibility and focus on corporate culture
- Corporate law theories – seek to explain how corporate law should balance these interests (Bottomley text Ch 2)

## 4. Types of Companies and the Corporate Life Cycle

### 4.1 Types of companies

- Over 2 million companies in Australia → there are two main types:
  - Public (Ltd)
    - Larger scale companies → greater ability to raise funds
    - May apply to be listed (or “floated”) on financial markets (e.g. ASX) → the companies shares may then be traded
    - Listed companies have more disclosure, reporting and compliance obligations
    - Other examples of public companies include not for profits and registered clubs
  - Proprietary (Pty Ltd)
    - Smaller scale companies → may be classified as a small or large
    - Most local businesses are these
  - Corporate Groups
    - Parent (holding) company and subsidiary companies

### 4.2 Corporate Life cycle

- Incorporation → Registration → Operation → Growth / change of structure → Winding up (either due to insolvency or resolution of members) → Deregistration

## 5. Internal Management of Companies

- Directors may be classified as:
  - Executive Directors → Employment contract with the company (e.g. CEO)
  - Non-executive directors → No employment contract with company → only real association through role as a director on the board
    - Board of Directors → Chair of the Board
    - Company secretary
- Larger companies and organisations have in-house an corporate counsel
- Constitution → sets out rules for the governance of company → e.g.
  - Issue and transfer of shares

- Powers of directors
- Authority of agents and corporate contracting
- Meetings of directors and members
- Changes to company structure and activities
- Has the effect of an enforceable contract between company and its members

## 6. The Development of Corporate Regulation in Australia

### 6.1 Corporate regulation in Australia

- Earlier examples of corporations (e.g. British East India Company) → Incorporation by royal charter or specific legislation
- UK companies legislation from 1844 onwards → Australian colonial companies legislation
- Cth Constitution s 51(xx) → Foreign corporations and trading or financial corporations → interpreted narrowly to apply to already formed companies
- Responsibility for corporate legislation rested with States and territories → e.g. Uniform companies act 1961
- Inadequacies and inconsistencies in regulation of companies and financial markets by State-based Corporate Affairs Commission
- Examples of corporate and market collapses
- 1980s → National Co-operative Scheme - Companies Codes; National Companies and Securities Commission
- 1990s → Corporations Law Scheme; Australian Securities Commission
- There were constitutional challenges over cross-vesting legislation
  - So → State and territories voluntarily agreed to transfer corporate regulatory powers to Cth → renewed every 5 years → Hence we now have a *Corporations Act 2001* (Cth)
- ASIC created
  - The regulator for companies, financial markets, financial services, → more recently consumer credit and business names
  - Regulation → Registration and licensing, policy guidance, investigation and enforcement functions
  - Maintains public registers of Australian companies and financial services providers
  - Also responsible for consumer education on financial matters

## 7. Themes throughout Corporate Law

- Corporate law → involves both legislation (*Corporations Act 2001*) and common law
- Some themes examined in this subject include: