# Corporate Law – exam summary notes

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Exam hints

Corporations Legislation
- Section 9 CA Definition provisions is particularly important
- Remedies are at the back
- Always consider statute first, and look at cases when you don’t know what it means

Exam practicalities
- All relevant facts will be provided – don’t have to make too many assumptions
- Need to determine ‘what is the main issue’ v ‘what just needs to be managed’
- List out the issues and rank them in order. Tackle the main issue first, if you don’t have time for the minor issues, move on
- What are the material facts in the question
  - Who are the parties
  - What are they doing
  - Who is it affecting?
  - If there are dates, percentages etc – they are there for a reason!
- Relate the facts to the various issues
- The more facts that relate to a particular issue, the more likely it is that this is the main issue
- You’ll see elements of specific cases...
- Don’t need to repeat the law! Just apply it.
- Focus first on the remedy – what do you want, THEN – how are you going to get there - be methodical about how you get there, and don’t lose the context of why you want to prove the breach
- Be very clear about who you are advising – what do they want? STATE WHAT THEY WANT!
  - Eg I am acting for X, I am assuming they want Y, best way to achieve that is to frame it with...X laws, principles and cases to support
    - Non-executive director
    - CEO
    - Whole board
    - Member
    - ASIC
      - Note that ASIC can come up in any topic...how does your advice change if asked to advise what ASIC can do
- If the question is more about the directors and what they’ve done, probably looking at directors’ duties
- If the question is more about members and what has happened to them, you’re looking at members’ remedies
- Be very clear about which entity you are dealing with (one person can act in a number of capacities)
Course revision – exam notes tips

- Lifecycle of company from beginning...
  - Different types of companies
  - Setting up a company
    - Should be familiar with the basics of how to set up a company
      - Name
      - Capital structure
      - Who are the directors
        - How many directors
        - Who can appoint directors
        - How are they appointed?
          - Difference between board appointment and members appointment
        - How to remove directors – where board is unhappy, can the board remove one or more directors?
        - Have in your notes all of the above! (differs depending on whether public or proprietary company)
    - Basic knowledge of the various parties eg company secretary, CEO, CFO etc
  - Capital structure
    - Limited by shares?
    - Really need to know how a share works!
    - Equity tier in the capital structure
      - One type
      - Multiples classes
    - How do you change it?
      - Who are you advising?
      - What are you advising them on?
      - Rights and remedies
      - Draw on the constitution
      - How is it relevant if the constitution is breached (bearing in mind s135(3))
      - $136(2) special resolution
      - Good understanding of what requires a special resolution (75%) v ordinary resolution (50.1%)
        - This is listed in some books, or you can search Austlii
        - Have a list of this somewhere, as the question will give you some voting powers (eg X no shareholders with X% shares – the percentages are there for a reason!)
        - Ask yourself why the percentage is there!
          - Eg s249D – can call a meeting, but cannot pass resolution without majority of shares
          - If 25% may be able to block special resolution from being passed with someone else on their side
          - Certain things can’t do
          - If they have 75% then you’re getting into a Quasi Gambotto territory...shares are still personal property, but exercise of decision subject to equitable bona fide for proper purpose
Company constitution
- Internal management of company undertaken
- Fundamental decisions
- Base rules of the company; eg
  - Meetings
  - Right to information
- Have to make assumptions about what might be in the constitution
- Easiest to assume that a company has not replaced the replaceable rules
- Set of rules in the act to work with as default provisions

Have in your notes...differences between proprietary company and a public company
- So that you can say... eg if public, needs to do the following (table the differences)

Directors Meetings
- How does a company do something?
  - Acting on behalf of company (liability issues)
- How a company can make decisions itself s126; s124, s127 execution; s128/129 who can do what – depending if you’re advising a third party, might be different advice
- How much can be delegated? Not everything! Negligence.
- Go back to the constitution, range of replaceable rules (Northside Developments – Dawson J: single director has no authority to bind the company, single director is not a decision making organ, all directors as a body are required to make decisions, all of the board are responsible for decisions once a decision has been made)
- What sort of things might be decided at a board meeting
- What are the roles of the various parties at board meetings
- Roles and responsibilities of people making presentations to board...may be responsible for what is not said in the presentation
- Eg Hardies case... directors were responsible, but also CEO, CFO, GC responsible for what they do and do not tell the board... tricky point is determining who is responsible for what... negligence issues, what did and didn’t do
- Circulating resolutions
- Conflicts on the board

Members meetings
- Power
- Who makes certain decisions
- What are some decisions only members get to make and not directors
- Careful about conflicts... s191 – what happens if you breach s191; broader directors duties questions
- What happens if majority of the board has a conflict – if no-one can participate, how does a decision get made?
- Be clear about reserve powers; ratification – who can ratify, how, limits on, effect of
- Winding up a company...members make decision
- Ratification before or after to members
- Quality of disclosure...what is adequate disclosure
- What happens if company is insolvent or in financial distress...how does this change the relationship between the members and the board
- Once you become a decision making organ with majority of shares, equitable limitations on voting, duties are imposed on you (can do whatever you want as a member but will be subject to standards if you’re a majority member)
- How do you hold a meeting
o What can you hold a meeting for – what would a proper purpose for holding a meeting be (case law for “what is a proper purpose”)

o What is the difference between AGM and other members meetings

o What is the period of notice? If you see dates and periods, meetings...start counting! Is it 21 days? Period of notice for proprietary, is it 28 days? That’s public.

o What does a chair do

o What is a proxy vote

o What if it all goes wrong! How do you assess that under the variety of topics...meetings, members remedies, directors duties
  ▪ What is purpose meeting...

o S1322 is it just a procedural irregularity, court can make the problem go away!

S1311...criminal provision...difficult corporate clients! if corporations act requires/prohibits and don’t comply, it is a criminal offence punishable by fine unless there is a different penalty (crosscheck under s3)
  ▪ Only if this is really relevant

o S1324 injunction provision (if ASIC)

• Don’t need to memorise disparate rules, mark up notes within the corporations act...

• Make sure you are very clear about which entity you are dealing with...who are you advising? Who are you acting with? Remember Salomons case you can be acting in a number of different capacities... do not make assumptions in your argument that someone is acting as one person throughout

• Liability
  o Is it a contravention of the law

  o Does it apply to companies

  o Individuals

  o Accessory?

  o What level of knowledge

  o Issues like veil piercing can come up...this is very hard to get! Need a well established statutory ground to do it...usually easier to rely on primary liability

• Assess the issues
  o Look at principles

  o Sections

  o Then...how do you look at the topic for each party
    ▪ Eg non-exec director
    ▪ Ceo
    ▪ Asic
    ▪ Whole board
    ▪ Member

  o Note that ASIC can come up in any topic...how does your advice change if asked to advise what ASIC can do... consider the different perspectives (never going to be just about the contravention) – which client are you advising? What do you think they want? STATE THIS!

Acting for X, I am assuming they want Y, best way to achieve that is to frame it with...these laws, principles and cases to support

  o Focus on the end point! What is the last thing you are going to say? I want eg an injunction!

  Who can apply, how to get, contravention, defences to application

  o Don’t leave the breach out of context! Need to be methodical... can I get to X point, what do I need to do to get there...
Autumn 2014 practice exam
If the focus of the question is on what the directors do…directors duties

If it is more about members and what has happened to them, you’re looking at members’ remedies

Q.a

• XP cannot choose who is the CEO – cannot remove CEO
• Board chooses who to appoint to CEO
• Company to hold meeting, company to pay for
• Requisition meeting but they cannot control what happens or passage of resolution
• They could distribute material… what their contract means for competency of board
• If you own 15%; who else is going to participate? Probably 18% fourth avenue would be opposed…so you need 50.1% of those actively participating in the vote.
• XP might have other rights…requirements of Corporations Act
  o S229 financial benefit
    ▪ Providing finance; issuing securities (229(3)(a);(e) – s208 is satisfied, if not exception s210- possible arms length? Remuneration consultant has assessed reasonableness; or 2011 – benefit is remuneration – must be “reasonable”
    ▪ S209… injunction – consequences of breach, interests affected, remedy
  o Termination payments…could get an injunction as termination payment with no member approval…possible damages breach of duty of care
• Possible statutory derivative action…but here, wouldn’t talk about the nature of the breach because you would have to assume there was a breach…focus on the procedure of SDA. Eg standing, leave, ratification etc… could distinguish McCracken because not looking for damages
• Oppression of minority… termination payment

Q.b

• What form of action to get directors to pay compensation
  o Breach of duty of care – sounds in damages – have to prove harm
    ▪ Significant transaction
    ▪ Is a short presentation sufficient?
    ▪ Centro CFO case – duty of care, didn’t read the report – can’t just read the summary!
    ▪ No evidence that the directors have personal interest in it
    ▪ Seems to be business judgement – difficult to say (180(2)(d) would be satisfied) as unlikely to say they could not reasonably believe it was appropriate
    ▪ Duty to monitor? Consultant not getting up to date information
      • What is the information flow int the business? Some small parts of the question that might suggest directors not doing their job properly
      • 1317s civil penalty 1318 general
  o Remember always look to the statute first…supported by cases when you don’t know what it means etc
THEME 1 – CONTEXTUAL & THEORETICAL ISSUES

This topic introduces the idea of a corporation and the role of corporate law. It looks at the structure of the Corporations Act, justificatory theories behind the design of corporate law, and critical approaches to the analysis of corporate law. This model will become more sophisticated in design and application as the subject goes on. This topic also focuses on some of the key stakeholders in a company including shareholders, directors, creditors, employees, suppliers and the wider community. Different and sometimes competing theories of corporate law are used to assess the basic question of the separation of ownership and control that exists within many corporations (particularly large public corporations). It will also canvas corporate social responsibility.

- What is corporate law?
- How are corporations regulated?
- Why are corporations regulated?
- Corporate goals and social responsibilities
- Corporate theory

“The locus of corporate control”

There is a complex relation between ownership and control of the corporation. Those who own do not control the corporation and conversely, those who control do not have significant ownership interests. This thesis on the divorce of corporate ownership from control prompted a critical reassessment of the conventional wisdom on the nature of property rights inhering in corporate share ownership, the social role and responsibilities of the large corporation, the legitimacy of corporate power, and the accountability of those who wield it. There are 5 major control types:

1. Private Ownership – control through complete ownership
2. Majority Control – control through ownership of a majority of issued capital
3. Control through a legal device – control secured through a legal device without ownership of majority of capital eg pyramiding (Corp A holding majority of capital of Corp B which holds majority capital of Corp C etc), non-voting shares or pooling arrangements
4. Minority Control
5. Management Control – by proxy votes

Corporate law’s project differs in each system of control. Under the dispersed ownership model (United States, the UK and to a lesser extent in Australia), legal regulation seeks to assure investor confidence in securities market integrity; its enduring challenge is the problem of shareholder passivity and the absence of incentives to monitor management and hold it accountable.

In concentrated ownership systems, law’s primary task is more the protection of minority shareholders against the temptation for the controller to run the corporation in its own interest at the expense of the minority. The dispersed model produces, or permits, weak owners along with strong managers; weak regulation requires strong owners.

CORPORATE GOALS AND SOCIAL RESPONSIBILITIES

If in fact managers of large corporations are free of close shareholder control, how do they define corporate goals? Do they substitute personal interests, the corporate organisation or society? And what ought they adopt in discharge of corporation’s social responsibilities? Strict profit maximisation, unremitting (constant) social amelioration (betterment) or some intermediate position between these two extremes? Although directors and managers have discretion as to the means by which the goals of profit maximisation and shareholder wealth are to be achieved, they are not free to act for fundamentally different ends and purposes. However, as a social as well as an economic institution, the corporation must comply with the law and may
Managerialist theories of the corporation

**Primary purpose of the corporation as a legal entity:** a means of coordinating production functions which is efficient in so far as it has lower transaction costs relative to contracting for them through the market.

**Main objective of corporate law:** management hierarchy is able to monitor and coordinate the activities of a number of business units more efficiently than market mechanisms. The corporation emerges from a process of natural selection in business forms as the optimal firm structure since it achieves the greatest reduction in agency costs.

The corporation is viewed as essentially a hierarchy; management is the principle subject of legal regulation. Two key strategies to constrain management power and strengthen shareholder controls include strengthening of legal duties imposed on directors and senior management and requirement of shareholder approval for a wider range of corporate transactions.

A company is more than merely the sum of its capital, it is an independent institution that management (as professionals) have a responsibility to run for the benefit of stakeholders (i.e. let management get on with it)

Another influential theory (as well as contractual theory) – there are duties imposed on managers (directors and offices only) – then it is captured by the law. Accountability...don’t want them to feather their nests and put their own interests before shareholders. **So is the theory saying that contractual theory, based on efficient markets, is not sufficient??**

Protection of investors and the public...

Need to arm shareholders with some rights...find this in Australia compared with the US – shareholders have powerful rights. Differences between US and Australia in our company law. In Australia, ability of directors to avoid their duties is much more difficult than in the US. Same directors duty is virtually non-existent in the US.

The managerialist theory of the corporation emphasises corporate management and the power that it wields. The issue is whether management holds and exercises this power legitimately.

The corporation is viewed essentially as a hierarchy, with management being the principle subject of legal regulation. Managers sit at the apex.

What accountability do we put on managers? Is there need for accountability? Are there checks and balances on managers? Rules against shirking, looting... the law responds to managers control.

In the managerialist theory, accountability is secured by the imposition of mandatory legal duties upon directors and other officers. Corporate managers are subject to disclosure obligations. Shareholder approval is required for a wider range of corporate transactions.
The corporation as contract
Also called shareholder primacy, this is the dominant theory in Anglo-American jurisdictions in determining the objective of large, public corporations.

Primary purpose of the corporation as a legal entity
To maximise shareholder wealth as the ultimate risk bearers

Main objective of corporate law

• Under contractual theory, corporate law is permissive and supplementary:
  o It limits the role of corporate law and state regulation to providing rules that deter one-off instances of management self-dealing (which cannot be prevented by market forces),
  o and imposing standard-form contracts that reduce the transaction costs of negotiating new contracts.
• 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
  o The “CORPORATION” is simply a highly specialised surrogate market
  o Reduce agency costs... less interference in terms of legal intervention, reduce legal costs. Set up default rules, “off the rack” eg fiduciary duties of directors
  o The contracting relationships are not contracts in the sense that lawyers understand, but rather the economist’s conception of relationships characterised by reciprocal relations and behaviour.
• Contractual theory rests on the assumption that the duty of management is to maximise the wealth of their principles, the shareholder owners of the firm and that the function of corporate law is to promote that end
  o Maximise short term or long term wealth??
  o The claim for shareholders is justified as they are the ultimate risk bearers in the firm, have entitlement to surplus income during the firm’s life and their usual monopoly of voting rights
    ▪ Their claims are last in line if the corporation is liquidated
    ▪ Arguable that shareholders are not the only ones who actually bear residual risk
      ▪ Employees, creditors, suppliers can be said to be residual claimants with a less liquid investment in the corporation (Keay article)
  o The hostile takeover boom of the 80s lent support to the claims of management accountability through the market for corporate control
  o Managers may do anything to enhance shareholder wealth provided that it is lawful (because failure to adhere generates risks which could prejudice the financial position of the shareholders ultimately)
    ▪ But what about considered risks, where the benefit to the shareholders exceeds the fines or punishment??
    ▪ Are directors/managers required to take these risks, to maximise shareholder wealth??
    ▪ Likely to lead to greater risk taking on the part of managers, where this is rewarded
  o Managers can consider other stakeholders, but “a corporation should only allot resources to constituencies to the point “where the marginal dollar spent yields at least a dollar in return to the shareholders” (Keay article)
• Contract theory emphasises the role of market forces, rather than legal rules alone, in aligning the interests of corporate managers and shareholders
Competitive markets are more important than mandatory legal rules in providing managers with appropriate incentives to maximise shareholder wealth.

These markets include the product market, the market for corporate control, and the managerial labour market.

The contractual theory does not imply the absence of legal rules, but asserts that to the extent that market forces require managers to act in the interests of shareholders, there is less need to seek this outcome through mandatory corporate rules.

**The validity of the contractual theory depends upon the efficiency of the markets**

- The market for corporate control should similarly discipline management, since any lack of efficiency should be reflected in the company’s share price, thus creating an opportunity for a raider to take over the company, install more efficient managers, and thereby realise higher profits.

- Yet there are limits on the effectiveness of the market for corporate control. It cannot be relied upon to discourage managers from taking action that increases their wealth at the expense of shareholders.

- It also only applies within a limited range – companies whose management is not inefficient enough to lower the share price to the point at which it attracts a takeover bid, and companies that are so inefficient that takeovers are deterred by the risks involved – both of these fall outside the range.

- There is also evidence that managers face only a very small prospect of dismissal (managerial labour market).

**Under contract theory, there is a preference to rely on the market for investor protection**

- Critics would say you are putting too much reliance on the market for investor protection, and there should be more rules and regulations to protect investors.

- This theory is working on the assumption that the market place is perfectly efficient. In the real world, there are disparities in bargaining power; information to the market is incomplete (could be misled, deceived, cheated) – some of the underpinnings in this model are open to criticism.

**This theory has a lot of weight in the US, because of the economic theory that dominates there.**

**Examples**

- **Australian article: “The High Cost of Company Law” by Adam Creighton** – *takes a contractarian approach to the operation of Australian company law*

  - “Legislative absurdity”
  - Common law, self-regulation and a heightened community awareness of caveat emptor (“buyer beware”) would fill the void if company law was suddenly abolished.
  - Shouldn’t the stock exchange, tax office or voluntary investor organisations insist on minimum standards, reveal those who don’t comply, and leave it to the market?
  - The Corporations Act is a tax on business, with QBE estimating the cost of mandatory financial services information provisions at $100/policy.
  - In NSW, 5100 lawyers are toiling away to ensure compliance with box-ticking minutiae of company law.

**What’s wrong with shareholder primacy theory?**

It ignores other parties’ contributions to companies, lowers other constituencies’ interests, encourages shareholder opportunism and eschews CSR.
Team production model
This is an alternate perspective on the objective of a corporation. Companies are not just contracts! Companies have a social element that is not being accommodated by the contractual theory. There are multiple inputs to achieve corporate success. Multiple inputs are based on a team of people. Task of the board is to balance the team member’s competing interests.

The board works for more than the stakeholders.

A public corporation is a team of people who enter into a complex agreement to work together for their mutual gain. Participants – including shareholders, employees and perhaps other stakeholders such as creditors and the local community – enter into a ‘pactum subjectionis’ under which they yield control over outputs and key inputs to the hierarchy. They agree to participation in a process of internal goal setting and dispute resolution. The role of board of directors is not to act as agents who ruthlessly pursue shareholders’ interests at the expense of employees, creditors or other team members, rather, are trustees for the corporation itself – mediating hierarchs (a mediating hierarchy) whose job is to balance team members’ competing interests in a fashion that keeps everyone happy enough that the productive coalition stays together.

This model is still centred around profits, still profit motivated, but get there by considering others and find other ways of coming to the same.

The Board is the “mediating hierarch”, balancing the interests of the corporation’s various stakeholders. Encourages efficiency-enhancing cooperation.

Blair & Stout argue that corporate law reflects a commitment to the TPM of corporate governance rather than to shareholder primacy. Millon rejects this proposition. But he has come back to say that the question is more complex.

- In today’s business environment, boards of most companies tilt decidedly in the direction of their shareholders, generally through quarter to quarter accounting results.
  - Lower level employees receive no more than minimum wage necessary to prevent defection.
  - Unwillingness to invest in nonshareholder wellbeing
  - R&D, marketing, maintenance, capital investment
- Corporate stock has turned over 650% in the past quarter century while real wages have stagnated!
- SO how can TPM be realised?
  - Legal reform could alter executive compensation practices and insulate directors from electoral pressures by providing for longer terms
  - Tax policy could be used to discourage short term investing
What is the purpose of corporate law?

- Public v private
  - Is a corporation a public transaction or a private relationship?
- Is a corporation anything more than the exploitation of private property rights? (see s1070A) – HC in Gambotto...share is more than a capitalized dividend stream, a share is personal property, more than just sum of economic returns you hope to get out of it.
- Should corporate law be used to address bargaining and wealth inequalities?
- Shareholder primacy revisited (eg TPM)
  - Are shareholders really the residual risk bearers?
  - Communitarian v economic perspectives
- Mixed goals:
  - Investor protection
  - Managing agency costs
  - Reducing transaction costs (including the competition for capital)
  - Efficiency v equity
- Feminist critique (and there are many feminist critiques of corporate law) to summarise them quite crudely: corporate law entrenches conflict, separation and existing hierarchy, individuals valued over groups, economic gains valued over other benefits
- Alternative foundations: trust, legitimate expectations and mutual responsibilities, the corporation as custodian

S198A is one of the most important sections of Corporations Act – directors manage the company...managerial prerogative – s198A is only a default rule, can replace it in internal operating rules, can contract around it.

Corporate Law is looking at the internal decisions, internal relationships between stakeholders – what is happening inside the company, who is authorised to do what. The central tension between providers and managers of capital – this underpins so many sections of the Corporations Act!

THE NATURE OF THE AUST CAPITAL MARKET

Dominant regulatory tool is disclosure – make them tell other people! If you do not disclose, prosecuted, if you lie, prosecuted.
THEME 3 – COMPANIES FORMED UNDER THE CORPORATIONS ACT

This topic looks at the concepts that form the basis for the incorporation of business enterprises under the Corporations Act 2001 (Cth). It will discuss the legal nature of share capital and provide an overview of the basic types of corporations, and the corporate organs and decision-making processes that operate within corporations. Corporate insolvency law will also be introduced including a brief general introduction and an examination of the challenges posed to traditional notions of corporate law that arise when the company is unable to pay its debts.

- How are companies registered?
- Internal capital structure
- Types of companies
- The corporate constitution
- Overview of corporate insolvency

Should be familiar with the basics of how to set up a company... See full subject notes for process of registration (~p20). A company has ongoing compliance obligations even where it is deregistered.

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<th>Ltd (public)</th>
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<tr>
<td>Minimum members and directors</td>
<td>1 member 1 director</td>
<td>1 member 3 directors</td>
</tr>
<tr>
<td>External audit and financial reporting</td>
<td>No (small) Yes (large)</td>
<td>Yes</td>
</tr>
<tr>
<td>Ability to raise money from public</td>
<td>Limited (s113)</td>
<td>Yes</td>
</tr>
<tr>
<td>Continuous disclosure obligations</td>
<td>No</td>
<td>Yes (depending on member numbers)</td>
</tr>
<tr>
<td>Need to hold an AGM</td>
<td>No</td>
<td>Yes</td>
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Shares

Shares are personal property (s 1070A), they are a bundle of rights. Shareholders are not the “owners” of a company, they own rights in the company to do certain things, including voting rights, right to transfer (publicly listed), right to receive dividends and capital when wound up.

Transferability of shares depends upon company’s constitution (ss 1072F, G)

The corporate constitution

If the company does not have a constitution, then the CA Replaceable Rules apply (s134)

The replaceable rules are set out in s141. One important issue involving this section arises where a proposal is made to alter the constitution in a way that will detrimentally affect existing shareholders eg Gambotto case – expropriation of minority shareholders. The HC set down a test that allows the alteration of an existing constitution. The power of the members to amend the constitution also gives rise to equitable considerations of fraud on a power.
The statutory contract (the constitution) does not impose obligation on, nor can it be enforced by, an outsider (Hickman; Morris v Hanley).

There is a lot of flexibility in writing a constitution, have to treat shareholders fairly, but is flexible in how you structure your business...whether you need to have meetings etc. draft constitution in a certain way.

Constitution operates as a contract between the members, the company and the directors s 140(1)

- If replaceable rules are used, breach is a not a breach of the Act s 135
- Main remedy is injunction and declaration
- Damages possible: McLaughlin

Members may enforce the constitution but only to the extent that it affects them in their capacity as a member: Eley v Positive Govt Assurance (named as solicitor).

Insolvency

Indicia of insolvency (probably need quite a few of these indicia for a company to be insolvent):

- Continuing losses
- Liquidity ratios below 1
- Overdue taxes
- Inability to borrow further funds or to raise further capital
- Bank requests to reduce overdraft
- Changing supply terms to COD, or otherwise demanding special payments before resuming supply
- Failure to pay within trading terms
- Postdated or rounded sum cheques
- Dishonoured cheques
- Special arrangements with selected creditors
- Enforcement action taken by creditors
- Inability to produce timely and accurate accounts

What may happen if a company becomes insolvent?

- External administration (CA Ch 5):
  - Receivership
  - Liquidation
  - Voluntary administration
  - Scheme of arrangement
- External administration shifts the focus from members to creditors
- External manager appointed to take over role of directors
THEME 4 – CORPORATE EXISTENCE – CHARACTERISTICS & CONSEQUENCES

This topic examines the separate personality (or persona/identity) ascribed to the corporation and its independence from that of the various stakeholders or other actors in the corporate enterprise. This topic explores when the personality is treated as a façade and an apparently corporate act is regarded as an act of one of the corporate stakeholders (lifting the veil). Here we will re-examine the scope of the legal protection investors rely upon when they invest in a corporation through the doctrine of limited liability. A further aspect of corporate personality concerns how doctrines of legal liability are applied to this fictitious legal person. Basic, fundamental questions are posed: how does a corporation, being an artificial entity, act? How does it sign documents and incur contractual and criminal liability?

- Introduction to corporate personality
- Salomon’s case
- Veil piercing – fraud on a power, Hardies case
- Corporate criminal liability
- Corporate authority/binding the company

Legal protection for investors – limited liability

How does a corporation act, how does it incur contractual and criminal liability

S119 together with s124 – a company is a separate legal entity with capacity and powers of natural persons. Effectively, this interposes a veil of incorporation between the company and its owners and managers. However, the ‘corporate veil’ may be lifted in certain circumstances under both statute (eg s588G personal liability on directors) and common law.

Salomon’s case: separate legal entity... the company at law is a different person altogether from the members. Owners, members and managers can be represented by the same person but in different capacity (Lee v Lee’s Air Farming; Hamilton v Whitehead).

The intention of the company is the intention of the directing mind and will of the company, which will ordinarily be that of the senior managers/executives (Lennards Carrying Co; Tesco Supermarkets; ABC Learning Centres).

Difficulties arise with Corporate Groups. Directors should take into account the interests of creditors for the corporate group...Bell; must not disregard their duties to individual companies in the group

There are 3 ways to find companies liable for breaching torts (see long notes “p34)

1. Vicarious liability of corporation
   • State of mind of employee is key
   • Acting within scope of employment
   • Can apply to strict/absolute liability criminal offences (Mousell)

2. Primary corporate criminal liability
   • Directing mind and will of the corporation
     • Lennards Carrying Co
     • Tesco

3. Attribution theory
   • Meridian – legislation intended that company was liable for the actions of its employees
Corporate Crime & the Criminal Code Act – for Commonwealth offences committed by corporations, including most criminal offences in the Corporations Act, codifies Tesco with slight adjustments. Adds new principle of ‘corporate culture’ that permits or fails to prevent criminal offence.

Checklist for corporate criminal liability – a question on criminal liability, this will help to structure an answer if you get a question on this. (Could also adopt this for tort...use vicarious liability for tort for (1); for (2) wouldn’t normally have state legislation, would look at ‘directing mind’; (3) wouldn’t normally talk about accessorial liability...you would say, were they knowingly involved in the tort?)

Criminal Corporate responsibility legislation provisions – “Criminal Code Act” are on “p37

1. Does the statute make it clear that actions of the employee will make the corporation liable?
   • Statutory vicarious liability: Mousell
2. If not, is it a State offence (eg NSW) or a Commonwealth offence?
   • For State offences, apply ‘directing mind’ analysis (Tesco) and ‘special rule of attribution’ (Meridian)
   • For Commonwealth offences, apply Criminal Code Act s.12 instead
3. Do any individuals have accessorial liability?
   • Hamilton

The law allows us to treat a corporation as a living thing. So in this context of corporate liability, prosecution has to prove 2 things:

1. Wrongful act (Actus Reus)
2. Mental intent (Mens Rea)

Obvious exception is for strict liability offences, where all that needs to be shown is MR. eg Food Handling, Environmental Law, OHS offences, Drug Offences (depending on statute) – typically not unusual to have these areas as strict liability.

So you have an artificial company, prosecuting a company, so how does a company be found liable?

3. Direct (primary) liability
4. Vicarious (secondary) liability

Eg employer not personally at fault, but liable for actions of employee (where in scope of their employment)

Vicarious liability (mainly for strict liability, or torts where no guilt required)

Mainly relevant for torts. State of mind of servant/employee is key, acting within scope of their employment.

Can apply to strict/absolute liability criminal offences.

Primary liability – various approaches to primary liability

1. Directing mind and will

We rely on the organic theory of liability – founded on agency law principles – where directing mind and will of the company comes in

5. The person who embodies in the company (Tesco case)
   o Bolton case, where Denning L compares a company to the human body (p96 of the textbook has the quote)
Lennards case also captures these ideas – no mind of its own any more than body of its own, acting mind and will sought in someone who is really acting mind and will of the company, centre of personality of the company

THERE IS A PROBLEM WITH THIS APPROACH!

- This approach is useful but it has its limitations
- It works well for small company, just a couple of directors
- Does not work well with conglomerates, parent companies, subsidiary companies
  - Eg multinationals, with countries across the globe – with so many players involved in a complex scenario, you cannot pinpoint who the ‘directing mind and will’ of the company. The courts do use it, but it has its limitations

2. Attribution theory

If the statute is not clear about vicarious liability, and the person who committed the act was not the directing mind and will of the company, can the company still be found liable for the individual’s acts?

Court may create a ‘special rule of attribution’ to attribute the acts of the individual to the company

ABC case: childcare – assistants that did not represent ‘mind and will’, relied on Tesco case. The HC said, No – can rely on attribution approach. Judge looked at statutory provision and parliamentary’s intention (second reading etc) – determined that it was parliament’s intention to make childcare owners accountable for care of children – it would defeat aim and purpose of legislation to use the directing mind and approach in interpreting statute that is all to do with care of child...does not matter what level of employee is involved, junior or senior –not wedded to embodiment approach in Tesco

When you look at the Criminal Code, see the content of the Code goes much broader than common law approach to determine liability – goes beyond the Tesco approach. Introduces corporate culture. AR – can be committed by a range of people (whereas embodiment Tesco approach is only looking for directing mind and will of company) – company can be answering for them if they are acting within their authority.

Corporate liability for contract

The rules used for contracts are completely different to the rules used for tort and crime. Do not talk about ‘directing mind and will’ or ‘vicarious liability’ – these are reserved for tort and crime. In contract, use AGENCY LAW.

How may a company enter a contract?

1. Directly
   - through one of its organs, usually board of directors (note 198A) or
   - by statutorily authorized person(s) affixing the co seal 127(2), or without seal 127(1), or executing deed 127(3), or

   Default rule is that 2 directors is enough...

2. By an agent with authority - under s.126 [company can enter a contract through an agent who has been given express or implied authority] were they an AUTHORISED AGENT? - if they were, corporation will be liable for the contract. With actual authority – express or implied
   - Express:
     - Stated or agreed in writing e.g. board resolution or company constitution or in company’s contract with agent (s.198D)
   - Implied:
even though not directly stated, actual authority can be implied from trade usages, (eg standard forms, pattern) course of business between the parties, appointment to a particular corporate office (eg managing director), or acquiescence (has allowed someone to act as if they are in a senior position) – company allows a person to act in a capacity for a long time

- *Hely-Hutchinson v Brayhead* - not clear how many times have to do it before it becomes a course of conduct
- What authority is ‘implied’ by appointment as a director?
  - Generally, need at least 2 directors, or one director plus one secretary, to sign contracts for the company, unless they are sole director companies (s172 default rules)

Further protection for outsiders in statute: Sections 128-130 Corporations Act

- s.129: Codification of the common law ‘internal management rule’ in Turquand: slightly different wording Turquand codified and slightly modified...should read this section of the Corporations Act! Note that it makes more sense to start with 129, then go back to 128...have to talk about both sections.
- s.130: Outsiders are not presumed to know information about companies that is available to the public from ASIC
- s.128(4): exception if outsider ‘knows’ or ‘suspects’ assumption not true: modification of *Northside* test
  - Suspicion is “a positive feeling of actual apprehension or mistrust, amounting to a slight opinion, but without sufficient evidence”: Eden Energy v Drivetrain (2012) 90 ACSR 191 (WASC)
  - *Northside* can be used for some principles relating to authority (ie 1 director by themselves would not normally have power to bind the company) – but *Northside* created a test regarding ‘nature of transaction’ which should have put outsider on inquiry...cannot assume properly entered into...BUT this test has been modified by s128(4) which has slightly different wording...cannot make assumption where KNEW or SUSPECTED that something was wrong (not whether should have known)...eg was there evidence that the bank officer expressed doubts? THERE NEEDS TO BE EVIDENCE – have to ACTUALLY know or suspect, not SHOULD.

3. By an apparent agent with ostensible/apparent authority - Under s.129(3) protection for outsiders who are given the impression by someone in the company that they have authority even where they do not

  - company has held out/represented that the person is an agent...outsider can then assume the agent is a company – has to be something that the company has done...either conduct/behaviour/words that make it clear that the person has been authorised, at least for the specific transaction
  - Freeman and Lockyer v Buckhurst Park Properties
  - Important: the person doing the representing must have actual authority to act for the company: Freeman and Lockyer; also Crabtree Vickers

Have to have actual authority to make a representation...but would it still be decided the same way today? Not sure. Look at s129(3) – could argue that company should have been bound because of the representation...this case was decided before the provisions came in.

**Treatment of legal groups:**
6. Conglomerates
   - Treatment at common law (Salomons case) – each legal group is its own entity
     - Which 2 HC cases are authority in this area? (Choice of 2, cite both even better)
       - Walkham v Windeyer: parent/subsidiary (should subsidiary collapse, cannot seek to recover from parent unless have taken a guarantee) – liability will fall with specific company you have contracted within the Group
       - Industrial Equity v Blackburn: parent company put hands into subsidiary and extracted profits for purposes of declaring profit, subsidiary argued against this...issue before Court: consent of subsidiary required – Court said, yes, consent is required as they are their own legal entities
   - Bloomberg is world’s legal authority on Corporate Groups and legal treatment
     - Bloomberg says, this was not thought through, to give companies this benefit – what you are doing is giving double limited liability by treating companies separately within the Groups... you are giving limited liability within limited liability...parent company may be wealthy, rich balance sheet – say, wants to expand business into a new market, it may choose to have a subsidiary with few assets...should subsidiary collapse, parent company will have its balance sheet intact
     - Unsurprisingly, companies do adopt a corporate group structure to exploit the law in this area
     - This is where you see the clash between corporate morals and legal issues...more often than not, ethical issues come off best (rightly or wrongly!)

7. More contemporary example of treatment of legal groups
   - James Hardy case – what led to ASIC finding entire Board in breach...JH restructured their company and transferred all their liabilities into a new entity (Research and Medical Foundation) – sum of money was given to this entity. Unions: the reason behind the restructure was to dodge compensation liabilities. Company: reason we restructured is because we are going to relocate company to Netherlands for taxation reasons. Truth? Who knows...subsequently relocated from Netherlands to Ireland. The point is - $300mil invested was underfunded by over $1 billion. If there was no special royal commission/ enquiry... if this had gone under the radar, medical research would have run out of money and employees would have had NO ability to go after the parent company... only that there were protests, public outcry, sympathetic labour govt to union movement, commission inquiry into the restructure, given the brief to examine the legality of the restructure...this report is available on the web! Or, 2009 Melbourne Legal Review Author – condensed version (by our tutor). ASIC used findings of the report to nail the board on the issue of breach of duty of care...not on separate legal entity!
     - Morally, what JH did was highly questionable... legally, they took the benefit of separate legal entity, so, no breach of law!!!

8. Companies...separate, distinct. Limited liability...does not extend to personal assets... expose third parties to losses when losses don’t extend to parent company. In JH, accountability was only a result of political pressure

9. Not everyone is on the same page, not everyone views fairness on the same legs
   - Depending on which corporate theory you subscribe to
   - Depending on your political alignment

10. Statutory exceptions where you can treat the entire group as one
    - Financial reporting (Corporations Act) is one

11. Common law – subject to statutory exceptions/defences
THEME 5 – CORPORATE DECISION MAKING

This topic builds on Theme 4 and explores in detail how the power to make particular decisions is allocated between participants in the corporation (principally, the board of directors and the shareholders as a collective group) and the degree of independence each group enjoys with respect to the exercise of their particular powers. This topic raises difficult questions concerning the apparent agency relationship between shareholders (as owners of capital) and directors/executives (as managers of that capital). This topic will discuss the important role played by the corporate constitution in dividing the powers between the different corporate organs.

- Directors- overview of their function
- How are directors appointed?
- Definitions of "director" and "officer" under the Act (including shadow and de facto directors)
- Remuneration of directors and executives (and the "two strikes" rule)

- Division of power between the corporate organs: s198A revisited
- Informal corporate acts
- Meetings of directors
- Meetings of members

Shareholders are supposed to be at the top – pyramid of obligations.

Directors are supposed to act in the interest of the shareholders. Directors & Senior officers are paid heftily for the role of managing the organisation. They in turn have these duties.

Supposed to act in the best interest of the corporation.

COMPLICATING FACTOR – in small organisations, shareholders/directors/managers are all the same! In large organisations, shareholders are too dispersed to have any influence.

**What is the difference between a director and officer?**

In one sense, they all owe fiduciary duties (s180, 181, 183 apply to all and so makes no difference). However, certain offences in the Act that only apply to directors eg 588G Personal Liability provision for insolvent trading. Previously, it also extended to officers, however under current provisions they have pulled out officers and it is only directors. Therefore, important to determine the differences.
Who is a director or officer?

**HOW TO ANSWER THIS QUESTION**

Clearly, has not been officially appointed as director

So, have to work with s9 CA – definitions

- De facto director (s9B)
  - What are the types of things a director would do? What are the typical activities of a director
  - Go back to facts, are her actions consistent with this?
    - Facts: only relevant thing she has done in accordance with s9B is negotiating a major contract, but facts are vague – does not say she has signed on behalf of company (even if she has, don’t know if she’s been delegated to do this specific task)

- See definitions in s.9: “director” and “officer” PAGE 83 Senior Managers are referred to in the CA as ‘officers’
  - a(1) Appointed as Director
  - a(2) Appointed as Alternative Director (if absent), standing in
  - b(1) Not appointed if act in position of Director...behaving like a Director, then treated as a Director in terms of duties to the corporation... eg attend Directors meetings and vote, making decisions about company’s business affecting large part of company’s business – called a “de-facto” Director.
  - b(2) – accustomed to act in accordance with instructions/directions eg In a family company, children on the Board, if they listen to the no longer on Board Father, they will be counted as a Director...person who is ‘behind the scenes’ trying to control what the Board of Directors does... referred to as a “shadow director”

Officer: making decisions which affect substantial part of corporations business

- Executive and non-executive directors
  - Senior Manager & elected to the Board = Executive Director (probably have the most power in the management – in 2 different parts of the company), this is the term used in the cases
  - Not a Senior Manager but you are a Director = Non-Executive Director
  - Not on the Board of Directors, but you are a Senior Manager = Executive Officer

- Independent (non-executive) directors: Supposed to have majority Independent Directors on the Board. Means they are NOT employees/Senior Managers of the corporation (non-executive), also don’t have certain business relationship with company. Will go over “independent” later...means more to be independent

- Chair of the board: Chair is always Director, as elected from among Board of Directors, so are on Board of Directors, responsible for leading meetings, ensuring agendas covered, will often act as spokesperson, makes sure everyone has a say in meetings. In a large company, Chair of Board should not be the CEO – supposed to be 2 different people in large public listed corporation “Corporate Governance Principle”. Board is supposed to “supervise” managers and ensure not acting in their own interests...act as a link between Senior Managers and the Shareholders. If you combine, will have too much power and will be able to improperly influence Board of Directors. Note though in the US, many companies share top role of CEO and Chair. Not considered good practice.

- CEO and other officers: CFO may not be on the Board of Directors, each company is different as to who they nominate to be on the Board of Directors. Usually CEO will be on Board of Directors, but won’t be chair.
- **Corporate secretary:** Usually just an Officer of company, ensure organisation complies with documents submitted to ASIC...responsible for compliance. May not be a Director, but each company is different.
- Will also have committees made up of Board of Directors people.
- Every company is different. Check company website to see who is on Board of Directors and who is not.

**Restrictions on being a director**

- **Human being? CA, s.201B** seems obvious, but possibility that you could be company that is director of another company – this is NOT allowed under CA. Have to “an individual” at least 18yrs old...some countries allow this, but not in Australia.  
  - See next slide for exception some companies have been “deemed to be Directors”...may be liable for breaching duties to company, even though never appointed as a Director
- **Bankruptcy & certain criminal offences:** s.206B Automatically disqualified if you become bankrupt. Only when going through bankruptcy process. Once discharged, can become a Director later on

Not all criminal offences count. If you are convicted of criminal offences relating to CA, or “dishonesty” – automatically prevented from becoming a Director.

- **Disqualification:** s.206C-F Can be disqualified by the Court...if you breach civil penalty provisions in the Corporations Act which mostly relate to Directors/Officers duties. ASIC can recommend to the Court that you are banned. During the time you are banned, cannot be a manager of any organisation in Australia.
- **Professional qualifications??** No. Just have to get shareholders to elect you. Anyone can set up a company and elect yourself as Director of the Company. If a big public corporation, owe a duty of care to the corporation, have to act without negligence...have to understand organisations’ finances. Certain level of knowledge

Threshold is very low to become Director of a Corporation!

**Shadow & de facto directors**

There are restrictions – just because you give advice, does not make you a director

Consider both the Buzzle case and compare with SCB or Grimaldi – look at both sides, are the making decisions or just protecting their interest??