Corporations Law 1

Module 1 – The Company

The Nature of the Company – Textbook Ford Chapter 1
Aspects of Corporate Personality – Ford Chapter 4
The Development of Company Law in Australia – Ford Chapter 2
Administration and Regulation of Company Law – Ford Chapter 3
Registration and Types of Companies – Ford Chapter 5
Corporate Liability – Ford Chapters 12-16

Module 2 – Corporate Governance

Management of Companies – Ford Chapters 6-7
Duties of Directors – Ford Chapters 8-9
Members Meetings – Ford Chapters 6-7
Members Rights and Remedies – Ford Chapter 11
Financial Reports and Audit – Ford Chapter 10

Module 3 – Corporate Finance

Membership, Shares and Dividends – Ford Chapter 18
Debentures and Charges – Ford Chapter 19
Fundraising – Ford Chapters 21-22

Module 4: Market Regulation and Control

Securities Market – Ford Chapter 21-22
Takeovers – Ford Chapter 23

Module 5: External Administration

Arrangements and Reconstructions – Ford Chapter 24-25
Receivers and Controllers – Ford Chapter 26
Voluntary Administration – Ford Chapter 27
Winding Up (Part 1) – Ford Chapter 28, Winding Up (Part 2) – Ford Chapter 28

Module 6: Partnership

Partnership
## 1. The Nature of the Company

<table>
<thead>
<tr>
<th>Theory</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Concession Theory</strong></td>
<td>Corporations are artificial entities created by the State. It regards the separate legal entity status of a corporation as a concession or privilege granted by the State. The narrowest interpretation of the theory would have it that the very existence of corporations is attributable to state sponsorship. Corporate personality exists merely for legal and business convenience as proposed by Lord Halsbury in Salomon v Salomon. A broader approach would suggest that the permission of the state is required as a prerequisite to doing business. A group as such has no rights unless the state chooses to grant it legal personality. It is strongly in favour of State regulation of corporations and a public law approach to such regulation.</td>
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<td><strong>Aggregate/Group/Contract Theory</strong></td>
<td>In favour of private regulation of corporations. A number of different approaches which come under the aggregate theory, however, what they have in common is that contract supplies the framework or conceptual paradigm. An association of individuals, it comprises contractual relations inter se and between members and management. In this context, the authority of the State is no greater than (or less than) its authority toward any other private agreement among contracting parties. The theory therefore asserts the pre-eminence of the individual and the private status of the corporation and consequently leaves little room for state regulation of corporations. The law’s role is to facilitate the formation of contractual relations.</td>
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<td><strong>Natural Entity Theory</strong></td>
<td>Corporation as a real or natural entity rather than an artificial construct. This approach attests to a difference to the Aggregate theory view that a corporation is just the sum of its parts.</td>
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### Ethics

*The Rothwells Collapse (read McCusker Report, pp 79-104 – on reserve)*

Commercial Banking Company (Private Company) controlled by Connell in the mid 80s – mid 90s. Very volatile share market during this period. Rothwell collapsed thus causing the share market to collapse. One of the director requested financial standing of Rothwells from Connell. Connell had actually directed million of dollars to his personal accounts and was unrecorded. Liabilities therefore did not appear as they should in Rothwell's balance sheet. Director did not receive any information and resigned. After collapse, another 340 million was lost. Did the director have any ethical obligation to warn about the impending doom of Rothwells? Assumption that Director's legal obligation is to the company, which means only obligation to the shareholders.

Public v Private Company. Company duty in core is to make money. To take into account of the interest of stakeholders would create conflicting interest between stakeholders and shareholders. Concept of trusts. Akin company to trustees. Arguing alone the lines of company as a natural person, if trustees have an obligation to the beneficiaries (primacy of beneficiary), similarly a manager has an obligation to take into the interest of its shareholders.
2. Aspects of Corporate Personality

a) Salomon's case sets the authority for the separate entity doctrine. Distinction must be drawn between the principles in the case and the result. The legislation of today may prevent the results reached in Salomon's case.

b) Salomon decide transfer company's money to his own account. S sets up the business. Transfers the asset and state that company paid him. Legislation made clear person set clear that company is distinct from person behind the company. Legislation did not speak of agency. The law treats the members of a company and those who manage its affairs as separate from the company. In other words, a company has a separate legal personality to those who own and manage it. For the purposes of the law, there is a corporate veil separating the company from the individuals behind it. This is so, whether the company is a large publicly listed company, or whether the company is operated and managed by a single person. The individual who runs such a company will therefore be treated as separate from the company in the law's eyes. There are however, certain circumstances, under which this corporate veil can be lifted and consequently the people behind the company can be held liable for acts of the company.

c) In Australia, the separate entity doctrine is generally strictly applied. In the words of Lord Halsbury in Salomon's case, there is a fundamental difficulty for the court in disregarding the corporate entity because "it is impossible to say at the same time that there is a company and there is not".

d) However the combination of the attributes of separate legal personality and limited liability have been used as a vehicle for the promotion of personal wealth and to avoid obligations which would have been personal obligations but for the incorporation of the business. Both the courts and the legislature have recognised that a mandatory application of the separate entity doctrine can adversely affect a wide variety of people and interests i.e.: shareholders, creditors, consumers, tort victims and taxation authorities. Consequently, in certain circumstances, the separate entity doctrine has been disregarded and this is generally referred to as "lifting of the corporate veil".

e) Corps Law existed before salamon. However, back then small business cannot incorporate their business because there was a fear of businesses using corporations as a vehicle for fraudulent purposes.

Generally speaking, at common law the corporate veil has been lifted on the bases of:

- Fraud
- Agency
- Groups
- Commercial justification
- Tort/Contract Distinction
- Improper conduct

<table>
<thead>
<tr>
<th>Characteristics of a Company as a result of the Separate Entity Doctrine</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Pros of Doctrine</strong></td>
</tr>
<tr>
<td>a) Business convenience</td>
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<tr>
<td>b) Negative effect of doctrine neutralize by legislation</td>
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<tr>
<td>c) Courts are more willing to pierce the corporate veil</td>
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<td>d) Lennard's case illustrates the logic why courts are prepared to lift the corporate veil since a corporation is an abstraction which has no mind and body of its own; its active and directing will must consequently be sought in an agent who is the directing mind</td>
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and will of the corporation, the very ego and centre of the personality of the corporation. bring up the salomon principle as a shield.

- Ford argues that the allowing of one-man company is contrary to the introduction of limited liability company since it is introduced “to encourage contribution of capital in associations.”
- Though Lennard may have modified the doctrine, it creates more question then answers. Who is the directing mind of the company? Arguably the doctrine still favours large corporations which has a small percentage of decision makers.
- Henderson argued that the contention that creditors can self-protect is based on the theoretical ‘efficient markets’ hypothesis, which assumes that all relevant information is available and immediately digested by the market, leading to accurate assessment and pricing of risk. This does not always happen in practice.

<table>
<thead>
<tr>
<th>Case</th>
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<tbody>
<tr>
<td><strong>Salamon v Salomon</strong></td>
<td>The Law only recognise “artificial existence” of the company. A corporation has its own legal identity and, is separate and distinct from the natural person that incorporated the company. In essence, a creditor will have no recourse against a shareholder, but only the company unless there is an element of fraud.</td>
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<td><strong>Foss v Harbottle</strong></td>
<td>Company is capable of suing and being sued. NOTE: Court will not intervene in irregularities in company if it can be resolved</td>
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<tr>
<td><strong>Caltex Refining Co</strong></td>
<td>Privilege against self incrimination is not enjoyed by a corporate entity</td>
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<tr>
<td><strong>Macaura v Northern Assurance Co</strong></td>
<td>A company has the power to dispose, hold and acquire property. The assets of the company belongs to the company, not the shareholders of the company since they have no legal or equitable interest therein</td>
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<td><strong>Macleod v Queen</strong></td>
<td>Consent of a shareholder cannot cure a fraud on a company. Conduct and will of shareholder does not necessarily attribute to the company. Reinforce the distinction between a company and its members. Members of the company can no longer take advantage of the company's separate legal personality to avoid certain legislation to misuse company's property.</td>
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<td><strong>Lennards Carrying Co Ltd</strong></td>
<td>Modified the Doctrine slightly. Acts of a person “directing mind and will” of the company is treated as the act of the corporation. A company cannot disassociates itself from the acts of a person that controls it</td>
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<td><strong>Tesco Supermarkets</strong></td>
<td>Alter-ego theory can be use as statutory defence based on the conduct being that of a third party. In order for a company to be liable, the fault must be on one that is “directing the mind” of the corporation. Normally, only officers of the company that carries out managerial functions speak and act for the company</td>
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<tr>
<td><strong>Section 124 CA</strong></td>
<td>Corporation has legal capacity and power of individual</td>
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**Exceptions to the Separate Entity Doctrine (COMMON LAW)**

**Note:** Henderson’s reason for piercing corporate veil: a) protection of creditors; (b) correctly attribute liability for the person responsible for wrong doing. He argues that the control testas the sole test for veil-piercing would be tantamount to removing the veil altogether in case involving a group of companies. He recommended an additional element such as an act of wrongdoing on the part of the parent company, either through its own actions or through the actions of the board of
the controlled subsidiary is required. A fault based approach. Piercing should be based on substantive grounds rather than means (such as agency). Grounds such as duty to act in good faith could be the model of imposing liability on parent company and would build on the liability of the parent company being shadow directors. He also suggested that the piercing of corporate veil should be best left to legislation. This is because it provides certainty which reduces cost of litigation. Secondly, "sending clear signals to parent company on use of corporate group. Finally, legislation would overcome the reluctance of courts to pierce the corporate veil.

**Gilford Motors**
Courts will treat shareholder and the company as one in situation where company is incorporated to avoid legal obligation.

**Artemus v Del Casale**
Illustrates the ineffectiveness of using incorporation as means of avoiding legal obligation. This is given the modernisation of corporations, the company may be alter ego of the person

**Smith, Stone & Knight**
The corporate veil could be lifted by establishing an agency relationship between a parent company and a subsidiary company. A right to control is sufficient to lift the corporate veil.

**CAN v Bird & Cameron**
Right to control is determinative factor. Valid commercial reason will allow courts ignore the separate entity principle and to lift the corporate veil. To focus on whether there is good commercial reasons for incorporation.

**DHN v. London Borough**
Group of company can be treated as a single entity

**Briggs v. James Hardie Ltd**
court should be relax in lifting corporate veil involving tortious conduct in contrast to contractual cases since in the latter one can choose the contracting party

**Exceptions to the Separate Entity Doctrine (LEGISLATION)**
Director may also liable under tax legislation, super annulation legislation, environmental and health legislation.

Who owns the duty: Director. Definition is section 9CA. Includes shadow and de-facto directors. Definition extends to person appointed as director regardless of name of position. Also extends to person not appointed as director but acts in a position of a director. Extends to person who instructs the directors as to how they should act. Circumstances that it might happen are when accountants advise company on its financial status. The term director can extend beyond its name.

Do non-executive director have different standard as oppose to executive director? **No. All have the same duties. However, a chair of a organisation will have separate duties. A person may have additional duties by virtue of their profession.**

**Section 197**
(1) Directors liable for debts incurred and other obligations incurred by corporation as trustee if:
(a) corporation has not discharged, cannot discharged the liability; and
(b) not entitled to be indemnified against the liability out of the trust assets because:
(a) a breach of trust by corporation; or
(b) corporation acting outside the scope of its power as trustee; or
(c) trust deed prevents or limit corporation right to be indemnified

**NOTE:** not liable if trust assets insufficient to meet indemnity. Protect unsecured trust creditors.

Insolvency test – S95A. Whether a company can meet its obligation when it falls due.

**Section 588G**
Section 588G makes directors of a company liable for debts the company has incurred if the company has traded when it was insolvent or there
were reasonable grounds for believing it was insolvent. Insolvent means 'not solvent', in other words, it is where a company cannot pay its debts as and when they fall due. Contravention results in the order of civil penalty provision (compensation order under 1317H) which renders director liable under section 1317G. Objective of duty: Make sure that directors don't incur company debts when the company can't pay for and to prevent insolvent trading.

Insolvency test – S95A. Whether a company can meet its obligation when it falls due

One of the purposes served by the insolvent trading scheme is to ensure that the critical role of credit in commercial life can proceed without the additional costs of inquiry about such matters.” – Spiegelman CJ in DCT v Clarke

A director’s passive neglect to the running of the business is no defence against personal liability. (Morley v Statewide Tobacco)

Reinforce the view that directors should not be passive. Pro-active steps are required to be taken in respect of director duties. A director is under legal obligation to understand the financial status of a company regardless of his/her financial sophistication. Whether a director receive remuneration is irrelevant (Commonwealth Bank v Friedrich & Ors)

Core irreducible requirement for directors to participate in management of company despite the variability of the skills. Inexperience of management is never a 'good reason' under section 588. A defence under s588H(4) operates on a presumption that every director is under a duty to monitor the company (DCT v Clarke)

A director must prevent a company from incurring debt if there is reasonable suspicion that the company is involved in insolvent trading. (Elliott v ASIC)

DEFENCES

There are certain defences to a s588G action which include:

- Where the director had reasonable grounds to suspect the company was solvent: s588H (2);  
  **Note:** test to establish liability is suspicion while defense is reasonable belief. Ignorance of company’s finance is not an excuse.
- Where the director relied on competent and reliable officer who claimed the company was solvent: s588H (3);
- Where the director was ill or had some other good reason not to partake in management of the company: s588H (4);
- Where reasonable steps were taken to prevent the company from incurring a debt: s588H (5) see also s588H (6);

<table>
<thead>
<tr>
<th>Section 180-184</th>
<th>Breach of director duties</th>
</tr>
</thead>
<tbody>
<tr>
<td>Section 260A</td>
<td>Giving financial assistance.</td>
</tr>
<tr>
<td>Section 588FB</td>
<td>Uncommercial transaction</td>
</tr>
</tbody>
</table>
a) Consequences of the Separate Entity Doctrine

Environment Protection Authority v. Caltex Refining Co (1993) 178 CLR 477

**Rule:** Corporations do not enjoy the privilege against self incrimination.

**Facts:** CR argued that they have right against self-incrimination

**Ratio:** 4-3 decision. Corporations could not enjoy the privilege against self-incrimination. Majority based decision on the law is never about rules and principles but about the context of the rule. Rule against self-incrimination in context. Majority said that right to self-incrimination is a human right. Minority approach is that what traditionally defined as a human right was part of the rejection of an inquisitorial approach in the criminal law. In Australia is an advocacy/ adversarial based system. The defendant does not have to answer question.

**Note:** Should charter of human rights to corporation. In Canada, human rights extended to corporations?

Foss v. Harbottle (1843) 67 ER 189

**Rule:** (1) The right plaintiff rule. A company is capable of being suing and being sued. A shareholder cannot bring an action under his/her own name to recoup any actionable loss in the value of his investment in the company (by fraud or otherwise). Only a company can sue its directors for their wrongs

(2) Court will not intervene in internal irregularities if it can be resolve by the company.

**Issue:** Whether a Corporation could be sued in its own name.

**Facts:** Foss is a minority shareholder in Victoria Park Company while H was a director. H purchased a land using VP’s monies for himself. It was alleged that the monies withdrawn from VP exceed the price of the land. In order to withdraw monies from VP, he mortgage the property of VP to raise the monies. Foss brought an action against H. Court held that when a company is wronged by its directors, only the company has locus standi to sue because the loss is to the company as a whole. Foss in this case is not the right plaintiff

**Ratio:** Court noted that since the company is a incorporated body, the defendant's conduct is not only injurious to the plaintiff, but the corporation as a whole. The court also stated that it will not intervene in any internal irregularities where majority of the shareholders may lawfully ratify irregular conduct and that in case of a alleged wrong, the plaintiff is the company.

**Note:** H was the principal director of VPC. If one does not allow shareholder to have recourse, situations like this will happen all the time. Legislation such as section 232, 236, 461 prevents this. If company can resolve its own irregularities, it would be illogical that H would be able to absolve himself of his wrong doings and pursue legal action against himself.

*Salomon v. Salomon & Co Ltd [1897] AC 22

**Rule:** A legal company has the rights and liabilities of its own. A corporation has its own legal identity and, is separate and distinct from the natural person that incorporated the company.

**Issues:** Whether SCL is a company pursuant to the Companies Act

**Facts:** S sold solvent business to SCL, which he and his family members were shareholders. There was compliance with the Companies Act. 10000 debentures were issued out to ED during a period of time. SCL applied for another 20,000 shares. SCL held 20006 shares at the point of compulsory liquidation. Having default on the 10000 debentures issued, ED enforced his security against the assets of SCL. Liquidation order is made thereafter by unsecured creditors.
Corporations Law 1

Synopsis

It was alleged that the price paid by the company exceeds the value of the business and the sale was a cover to defraud the company's creditor. There were also further averments that the debentures were issued in order to carry on the business without liability attached to himself. CA rule against S and decided that S was carrying on a "one-man" business with a limited liability front contrary to the Companies Act and enabling S to option preference of credits by means of debentures. CA judgement overturned. The company was duly formed. S not liable to indemnify against the creditors.

Ratio: The courts took a very strict interpretation of the legislation. Lord Halsbury examined the statute and recognised that the first condition was satisfied, namely, each of the shareholders acknowledges themselves being shareholders. He noted that the law should only recognise "artificial existence" of the company as oppose to conducts and motives of corporators. He is of the view that once the company is legally incorporated, it must be treated like any other independent person with its rights and liabilities appropriate to itself, and that the motives of those who took part in the promotion of the company is absolutely irrelevant in discussing what those rights and liabilities are. Unless, it can be shown that there is proof of fraud. It is difficult to say at the same time there is a company and there is not”

He commented that the CA’s judgement that S was using SCL as an agent for his business is contradictory. If the company is a legal entity, the business would belong to it and not S. If it is not, there is no thing or no person to be agent at all. Secondly, the CA’s judgement are mostly constructive interpretation of the statute. There is no limitation that the shareholders of the company must be an independent and beneficially interested person. The CA had neglected that legal existence of the company and emphasis much on S being a major shareholder of the company.

Lord Watson found it difficult to accept the argument that the company was formed contrary to the intent of the Companies Act. To find use intent of the legislation in a proper legal sense would be to say that there could be no legal corporation if there is no corporation. Thus, the creditors would have a remedy. A strict interpretation of section 8 of the Companies act would show that all requirements of the act have been complied with. There are no limitation as to how many shares a shareholder can have or whether they can be related to each other. The preponderating shares of S, the payments of the debentures are not forbidden by the Act and would not render the company invalid. He recognises that the law does not impose obligation on the company to warn creditors of the fact that they run the risk of not being paid. An apathy of an investor cannot justify fraud on part of the company that has provided all information under the Act. A creditor who does not take steps to protect himself must therefore bear the consequences of his own negligence.

Lord Hershell is unable to adopt the view that the company serves as an alias for S since the lower courts recognised the company as a distinct legal person. A company may carry out business for its shareholders but that does not necessarily mean that there is a relationship of principle and agent. He is of the view that the company is valid once there are distinct shareholders in the company. It appears that Lord Hershell was only concern with the legal constitution of the company. To base judgement relied by the lower courts would have drastic effects. Especially on banking industries since many have converted to joint-stock companies (private companies). With regard to the argument that SLC is a “one-man” company, it is said that it is common for a business to be transferred to a company with 3-4 shareholders wherein some have little or no interest in the concern. It would make no difference if the other 6 shareholders in SLC were “dummies” since the act contains no enactment of whether a shareholder may benefit from the share he/she holds and it is not the concern of the creditor nor company.

Arguments: Kahn-Freund described the decision as calamitous, lamenting the ease with which companies could be formed. It has been argued that the Salomon principle if applied rigidly, may shield parties from people dealing with the company. The principle gave priority to a separate legal entity and ignore the economic realities of a one-man company. The criticism is two-fold. Firstly, gives apparently honest incorporators the benefit of limited liability in circumstances in which it is not necessary in order to encourage them to initiate or carry on their trade or business. Secondly, it encourages unscrupulous promoters of private companies
to abuse the benefit confer by the Companies Act enabling them to achieve a “wafer-thin incorporation of an undercapitalised company. Limited liability gives business an amour to escape the tyranny of unlimited liability. Limited liability discourages shareholders from monitoring and controlling their company’s commercial ventures. The company's creditors bear the burden of the risks inherent in dealing with limited liability companies. Different creditors bear different amount of risks especially employees who have no information on the financial standing of the company. Limited liability encourages such companies to take excessive risks because the directors of closely held companies have more to gain personally by shifting the risk of commercial collapse to corporate creditors than is the case with public companies’ directors. Coupled with the attributes of limited liability, the salomon principle serves as an ideal vehicle for fraud. A illustration would be of a undercapitalised $2 dollar company that chalks up huge amount of debts and then bring up the salomon principle as a shield. Salomon’s case has been instrumental in the development of modern capitalism and the immense social and economic wealth which it has generated. The House of Lords extended the principle so far as to cover small private enterprises. This move has had several negative consequences over time. However, it is also true that these have been largely neutralised by joint legislative and judicial action. However, it should be noted that the principle remains good since courts are now willing to unveil the corporate veil and impose liability on its members.- GV Puig, ‘A Two-Edged Sword: Salomon and the Separate Legal Entity Doctrine’, (2000) 7 Murdoch University Electronic Journal of Law

Macaura v. Northern Assurance Co Ltd [1925] AC 619

Rule: A company has the power to dispose, hold and acquire property. The assets of the company belongs to the company, not the shareholders of the company.

Issue: Whether M has any insurable interest in the timber

Significance: Illustrates the Salomon principle.

Facts: M own a estate and some timbers. M agreed to sell his timbers in exchange of the entire share capital of ICSM. Transfer business to company. The timbers were stored in the estate. Timbers were insured under M's name. Insurance was not transferred to the Company. Fire broke out in the estate and destroyed the timber. M tried to claim insurance but insurance company refused to indemnify M on the basis that the timber belongs to the company. The Court found that M could not be indemnify since the timber belong to the company and not M. Although M owns the company, he had no insurable interest in the property of the company.

Ratio: It may be true that the timber belongs to the company and the whole interest of the company belongs to M. But the principle in this case rest on something independent of the interest held. M could only insure as a creditor or shareholder of the company. It would be impossible to insure as a creditor since there is no case suggesting that all creditors must insure against the assets of their debtors. As for shareholders, it must be noted that shareholders has no right to any item of property owned by the company since they have no legal or equitable interest therein. If one were to have insurance against company property, it would be impossible to calculate one's share distribution diminished by the lost of an asset to the extent of his insurable interest.


Rule: Consent of a shareholder cannot cure a fraud on a company. Conduct and will of shareholder does not necessarily attribute to the company.

Issue: Whether a officer of a company is able to give valid consent on behalf of the company to use its fund for his/her benefit.

Significance: Reinforce the distinction between a company and its members. Members of the company can no longer take advantage of the company's separate legal personality to avoid certain legislation to misuse company’s property.
Corporations Law 1

Synopsis

Facts: M is a sole beneficial shareholder of Trainex Pty Ltd. Invited investors to invest. Raise 6 million dollars for film production purposes. Only use $700,000 for the same purpose. It was alleged that he fraudulently applied remaining property of Trainex for his own use and other purpose other than that of Trainex. Investors fund in the trust account were use to purchase personal property and other personal expenses. M charged with fraudulently applying property under criminal legislation. M argued that he cannot steal from the company that he control since he consented to the taking of the monies. Court disagreed and held that the consent of the sole shareholder consent to his own conduct was not the consent of the company to negate the allegation of fraud.

Ratio: The court rejected M's submission that prosecution has failed to establish the element of consent by the victim of the fraud i.e the Company. In the joint judgement of Gummow, Hayne and Gleeson, they stated that self interest of the controller of the company, given in furtherance of a crime committed against the company, cannot be said to be the consent of the company. They indicated that the conduct or the state of mind of the directors, officers or members of a company is not always to be attributed to the company.

McHugh J noted that the consent of a sole shareholder cannot cure what would otherwise be a fraudulent taking or application of the company's property. In applying the Salomon rule, he stated that the company has the legal and beneficial title to its property. While legislative restriction on fraudulent dealing by agents, trustees, and directors in property entrusted to them for a particular purpose predates the emergence of the separate legal entity concept, the provision must be read in the light of the dichotomy between the company and those who are its shareholders. It is important to note that the purpose of the body corporate are not synonymous with the intentions of the person in control. In the event that all shareholders agree to the taking of the company's property, all of them will be guilty under the crimes act.

Callinan J is of the opinion that if a shareholder were able to validate the use of company's fund by consenting to it, it would ignore the vital distinction of separate legal personalities. The fact that the natural person so acting is in effective control of the company does not mean that he is the company, or that no distinction may be drawn between what he does and what the company may and should lawfully do. A director acting in breach of his obligation by using the money of the company for his own purpose is not better than a thief who gains access to its treasury.

Note: Not charged under corporations act. M’s argument may be theoretically correct. Knowledge of M is to be taken into account but not his intention should not be imputed.

Lennards Carrying Co Ltd v Asiatic Petroleum Company Ltd [1915] AC 705

Rule: Acts of a person “directing mind and will” of the company is treated as the act of the corporation. A company cannot disassociates itself from the acts of a person that controls it.

Significance: Introduced the alter-ego theory in corporation law. Expands Salomon rule.

Facts: Cargo on board of a ship was destroyed due to the seaworthiness of the vessel. Under English legislation, the company is not responsible if loss is due to no fault of the company. The owners of the vessel was a limited liability company (LC). They were also a managing owners of another limited company. The managing director of the latter company, JM Lennard (also one of the directors of LC), was active in the management of the vessel on behalf of the owners of the vessel and had means of knowing the defects of the vessel. However, he did not gave any special instructions to the crew of the vessel and allowed it to sail in an unseaworthy condition. Court held the owners liable for the loss of the cargo. It was argued that the managing director was at fault and not the company. It was held that LC was the “directing-mind” of the corporation and his thoughts and conduct were those of the corporation. As such, LC cannot invoke the protection of section 502 of the Shipping Merchant Act to exonerate liability.

Ratio: The court considered whether the destroyed cargo was without the fault and privity of the owners of the vessel. In this regard, Viscount Haldane stated that a corporation is an abstraction which has no mind and body of its own; its active and directing will must consequently be sought in
an agent who is the directing mind and will of the corporation, the very ego and centre of the personality of the corporation. The person may be acting under direction of shareholders, a director himself or a person with prescribed authority. If a person were the directing mind of the corporation, his/her actions would be the action of the corporation. It is not enough that the fault should be the fault of a servant in order to exonerate the owner; the fault must also be one which is not the fault of the owner, or a fault to which the owner is privy.

**Note:** Trying to use technicality to get out of liability. Similar to Mcleod. Courts “modified” Salomon principle to deal with both cases.

**Tesco Supermarkets v Nattrass [1972] AC 153**

**Rule:** Alter-ego theory can be use as statutory defence based on the conduct being that of a third party. In order for a company to be liable, the fault must be on one that is “directing the mind” of the corporation.

**Facts:** TS is a public company with a chain of hundred stores. It advertised products being sold at a reduced price. All of such products were sold and full-price items were replaced by a store assistance without the knowledge of the store manager and the advertisement remain at the store. Customer tried to purchase item at reduced price but was not allowed. Information laid against TS for breach of trade description act. Under the act, a defence was available if offence was due to the act or omission of another person. TS argued that the store manager was “another person” for this purpose. HL held that the manager lacks sufficient capacity as the directing mind of the company and thus qualify as another person. Therefore, TS was not liable.

**Ratio:** Lord Reid considered the nature of the corporation as something that has no mind to hands to carry out its own intention. The actions of a corporation must be done through a natural person. That person who acts is not speaking or acting for the company but acting as the company and his mind which directs his acts is the mind of the company. It is a question of law whether a person in doing particular things is to be regarded as the company or the company's servant/agent. Naturally only officers of the company that carries out managerial functions speak and act for the company. He recognised that the board of directors can delegate managerial functions to its subordinates to make them an embodiment of the company. However, the delegate must have full discretion to act independently of instructions from the board of directors. Applying this to the facts, there is no such delegation and the board remains in control. The acts and omissions of the manager is thus not an act of the company.

**NOTE:** Does this favour large corporations since range of person who have the capacity to make the company forms only a small percentage. That would allow large corporation to avoid legal liability for the acts of most of its employee. The judgement is uncertain as to whether mid-tier management can be considered as “directing minds” of the company. Day-to-day decisions normally done in that level.

**b) Lifting the Veil of Incorporation at Common Law**

**Gilford Motor Co. v. Horne [1933] Ch. 935.**

**Rule:** Courts will treat shareholder and the company as one in situation where company is incorporated to avoid legal obligation. The veil of corporation will then be lift to make the shareholder accountable ignoring the legal entity of the company.

**Facts:** H is an managing director of GM. Restrain of trade clause in employment contract to prevent him from soliciting customers of GM. Concern with the clause, H incorporate business with his wife and issue 101 shares each after leaving the employment of GM. H argued that company solicited the customers not him. GM argued company is a sham to avoid legal obligation. GM sought injunction against H. Court held that company was a sham to cloak his own wrong doings

**Issue:** Can restrain of trade clause be applied to the company?
Corporations Law 1

Synopsis

**Ratio:** Court was of the view that the incorporation of the company was to perpetrate fraud. Farwell J opined that company was created to circumvent covenants that he was bound by. On evidence, it was found that H was the sole controller of the company. His wife and son had little role to play. Lord Hanworth M.R agreed with the judgement of Farwell J. He stated that the incorporation of the company was devised to mask the business of H. The purpose of which would enable him to carry out business effectively while using incorporation as a mean of avoiding the legal covenants that binds him. As such, the company ought to be restrained as much as H deserves to be restrained.

**Note:** First decisions when court say to ignore or modify Salomon. To pierce the veil of Salomon which Salomon places. What if it was the wife who set up the company and H only have a minor role.

**Artedomus v Del Casale (2006) 68 IPR 577; [2006] NSWSC 146.**

**Rule:** Illustrates the ineffectiveness of using incorporation as a vehicle to avoid binding legal obligation.

**Facts:** Evidence before court was that A sourced the marble from a particular Italian region that have exclusive contractual arrangement with supplier and particular marble was largest selling product of A. The marbles was marketed in Australia as Isernia but is proper name is Modica. A use a different name to prevent people from knowing the source of the marble. DC is a director and former employee of A. Employment contract contains a restriction of trade clause restricting DC not to compete with A and to keep confidential any commercial sensitive information he may be in possession of or have become aware of during his employment by the Company. However, the clause did not contain the words “directly or indirectly”. It would appear that only DC is personally liable to the clause. DC sets up another company and A brought an action against DC for breach of confidentiality, fiduciary duties and statutory duties. Court found in favour of A despite the wording of the clause.

**Issues:** Is there a breach of confidential duty? Breach of statutory duty as director? Did DC breach his contractual duty by breaching the non-competing clause.

**Ratio:** DC argued that the restrain of trade clause only applied to him personally and not his company or the company he works for. The court noted that the clause did not include any competition by a company even if owned by DC. However, Court was of the view that in the face of modernisation of corporations, the company may be alter ego of the person. As such, it would be necessary to look of object of clause and understand that the clause includes protection against any sort of rivalry in trade and embracing competition through the use of company. It was concluded that the incorporation of the company was a disguise. There was strong evidence that DC was a important member of the corporate structure


**Rule:** The corporate veil could be lifted by establishing an agency relationship between a parent company and a subsidiary company. A right to control is sufficient to lift the corporate veil.

**Facts:** BC sought to compulsory acquire land of SSK. Business conduct on land operated by Birmingham Waste. BW is a wholly owned subsidiary of SSK. BC said that they would pay for the land. SSK wanted compensation for the disturbance of the business. However, BC will not pay for disturbance of business because BW is a separate entity. Court held that corporate veil could be lifted because BW is merely an agent of SSK and found the business is ultimately run by the parent company. Therefore, allowing SSK to gain compensation.

**Issue:** Whether SSK is entitled to compensation from BC and whether BW is a agent of SSK.

**Ratio:** Court applied a six-stage test. Underlying essence is who controls the organisation. The test is as follows:
Corporations Law 1 Synopsis

1) where did the profits go?
2) who are the persons conducting the business?
3) who is the head and brain?
4) who decides what is to be done, when is it to be done, where is it to be done?
5) does the person make the profit by his skill and direction?
6) who is the person that with effectual and constant control?

The test must be satisfied in order for the court to ignore the Salomon principle. Atkinson J use this 6 steps to identify a agency relationship so as to pierce the corporate veil to allow the parent company to claim for the disturbance of business.

Note: Applied in Australia but has been questioned as much as it is apply. Does not by any basis have a broad intrusion into corporate veil. Use as ground of agency to intervene Salomon. Also note the distinction between Salomon’s case and the present case. In salomon case, the business is transferred to the corporation whereas the same cannot be said in this instance. The business remain under the parent company.

*ACN 007 528 207 Pty Ltd (in liq) v Bird Cameron (Reg) (2005) 91 SASR 570; [2005] SASC 204

Rule: Valid commercial reason will allow courts ignore the separate entity principle and to lift the corporate veil.

Facts: Professional negligence claim against firm of accountants, Bird Cameron partners. Client who is suing them is ACN. The contractual relationship with ACN is with a company call BPN proprietary limited. Contractual relationship is with BPN. BPN has no money. BPN carried out most of the firm accountancy work. BPN was owned by the partners of BC. The partners in fact owned client files of BPN. The directors and beneficial shareholders completely control BPN

Issue: Whether corporate veil and be lifted and attach liability to the partners. What is the nature of the relationship between the firm and the company and its partnership.

Ratio: Quote SSK and made critical difference. Pro accountancy rule BPN had a licence or right in its own capacity even though partnership control the whole company. BPN had its own name. Specifically, the judge said that control itself cannot pre-decisive indicator. Were there good commercial reasons to establish? Relevant to regard to the purpose the company was established. Very good commercial reasons that BPN is established. Such as super-annulation, transferred of profits and tax advantages and also liability issues, capacity to control and flexibility within corporate structure. Concluded that the predominate focus of the incorporation of BPN was not in any way to create an agent of partnership, not to design to insulate one from liability, there were legitimate commercial purposes for incorporation. There are also no beliefs that BPN is under resources for what it is design to achieve.

Note: Contrast with case of Smith, Stone & Knight. Besanko J criticised the 6-stage test in SSK. He commited that the 2nd to 6th requirement of the test focus too much on the element of control and control itself is not a decisive indicator of agency.


Rule: A group of companies can be treated as a single entity.

Facts: DHN ran business on a premise own by its wholly owned subsidiary company, Bronze. LBTH subsequently made a compulsory acquisition of the premise. Compensation were made to Bronze but not to DHN. LBTH argued that the other two companies did not hold any interest in the land and therefore not entitled to compensation. A held that DHN is entitled to compensation because DHN and Bronze were part of a single economic entity.
Corporations Law 1 Synopsis

Ratio: Lord Denning M.R argued that there was trend that separate entities in a group of companies are disregard. Instead, the group should be dealt as a single economic entity. This is especially so when the parent company wholly owns the subsidiary.

Note: Lord Denning may have placed too much emphasis on the fact that DHN owned all 3 companies entirely and that the directors or DHN are the directors of the companies are well.


Rule: Corporate veil should be lifted especially where tortious conduct is involved.

Facts: B contracted illness working in the mine owned by JH. Company that employed B was a subsidiary of JH. This subsidiary had limited assets. B wanted to sue the parent company, JH. The separate entity doctrine will render it difficult.

Ratio: Rogers J pointed out that a distinction had to be drawn between contract and torts cases. In Australia, it is accepted in contract cases, the corporate veil won't be lifted. In this case, Rogers argued that in torts cases, court should be relax in lifting corporate veil because in contract, one can choose the contracting party. One can see whether a contracting party is solvent. If action is in torts, one cannot choose his/her tortfeasor. Rogers J commented that the corporate veil will not be lifted simply because it can be shown that the parent company have complete control over the subsidiary.

c) Lifting the Veil of Incorporation at Statute (s 588G CA)

Morley v. Statewide Tobacco Services [1993] 1 VR 423

Rule: A director's passive neglect to the running of the business is no defence against personal liability.

Significance: Courts are now more willing to impose liability on passive directors.

Facts: Mr and Mrs director of company. Mr died and Mrs and son took over company. Son managed the business and controlled the business. Mother in this instance took no active role in the business. When business became insolvent. STS sued the Mrs Morley rather than the company since the company had no money. All assets and profits of company were in name of Mrs Morley. Court held that there was personal liability. Court found that Mrs Morley knew that son were incurring debt and she as a director had pass the control to her son. She agreed to the managerial function of company to son. Therefore, the debts were incurred under her authority. Importantly, the court said that the “days of sleeping directors were over”

Issue: Whether a passive director can raise the defence that debts incurred by the company was without her authority or consent.

Ratio: The court found that M’s acquiescence to her son’s control over the business was sufficient to establish that she consented to the incurring of the debt. Ormiston J held that a director who cannot prevent the company from incurring debt without the concurrence of the majority of the director was nevertheless obliged to take practical steps to prevent the company from insolvent trading. If that particular director is unable to stop the other directors from causing the company to incur debt, he/she should seek to have the company wound up or resign. A director should not be entitled to hide behind ignorance of the company’s affairs which is of his own making or, if not entirely of his own making, has been contributed to by his own failure to make further necessary inquiries.

Commonwealth Bank v Friedrich & Ors (1991) 9 ACLC 946

Rule: (1) Duties and legal obligation of director for a non-profit company is essentially the same as a director of a profit-making company.