What is a corporation?

- The term corporation or body corporate is a general term to describe all artificial persons created by the law.
- A legal structure (endulled?) by law to have legal rights and duties as a fictional legal person.
- A corporation is treated as a person separate from the individuals who own or operate it (from the management and shareholders).
- A registered company is a particular type of corporation which is formed by being registered under the Corporations Act.
- The Corporations Act provides for ASIC (Australian Securities and Investment Commission) a statutory body to register companies at the request of applicants.
  - S 119 provides that when ASIC registers a company, the company comes into existence as a body corporate at the beginning of the day of which it is registered – the company becomes a legal person.
  - ASIC confers the benefit of incorporation. Only the state can create an artificial legal person.

- A company can be formed with only one shareholder – s114 Corporations Act.
- A registered company from the Corporations Act is distinguished from other voluntary associations.
- Not all associations of legal persons need be incorporated.
  - Companies can be formed for many purposes – not just for making a profit.
  - The choice of structure for association can depend on whether the purpose of the association is for financial gain.
  - No need to incorporate if purpose is not to make profit.
  - If the purpose of the association is to profit – must incorporate if there greater than 20 members in the association: s115 Corporations Act.

The legal forms for conduction a business include:

- **Sole trader**
  - A sole trader or sole proprietor is usually an owner/operator of a business.
  - The individual carries the business in his or her own name or a registered business name.
  - No separation between the business and personal assets/liabilities.
  - The owner is personally liable for all the debts of the business.
  - The sole trader is the tax payer.
  - The business losses or profits can be offset against the sole trader’s other incomes.
  - Possible to form a company with only one member.
  - Enterprise is not a separate entity at law – Sole trader (does not have the benefits of incorporation).
  - Can have a sole trader or a one member company.

- **Partnership**
  - Definition: Partnership Act 1895 (Vic) s 5
    - The relation which exists between persons carrying on business in common with a view of profit.
  - Purpose is to profit.
  - A partnership as a type of association is narrower than a company as it can only exist for commercial purposes.
Members can be natural or artificial (can have a partnership in which one of the partners is an incorporated company)

A partnership has no separate legal personality (different to corporation)

**Two categories of partners**

- General partners: who manage the business
  - Have unlimited liability
  - General partners need not be registered
  - Limited Partnerships (Part IV Partnership Act 1958 (Vic))
  - Outsize Partnerships (see s 115; for various professions, eg legal practitioners, accountants)
    - Prohibits a person from participating in the formation of a partnership or association for commercial purposes, where the partnership has more than the permitted maximum number of members – 20
    - If you have more than 20 members must incorporate the partnership – become a company
    - There is no restriction on the number of members in a public company
    - S 113 limits the number of members of a proprietary company to 50. If it exceeds 50 (more than 50 shareholders), ASIC may require the company to change its status to a public company (s165)

- Limited partners: take no part in business
  - Liable only to the extent of their contribution to the partnership
  - Can’t take part in management
  - Limited partnerships must be registered

Effect of partnership’s lack of separate personality

- Ownership of property (right is only legally enforceable)
- Creditors
- Agency of associates
- Personal liability
- Contracts with association
- Who conducts the business?

**Joint venture**

- Contractual arrangement between several persons that they will join together to conduct a single project (rather than a continuing business)
- No legal definition of joint venture
- Common features:
  - Several legal persons participate in a single project – rather than a continuing business
  - Can be incorporated or unincorporated (doesn’t have to be a company)
  - Unincorporated joint ventures are more common (in particular in the mining industry)
- In order to prevent a joint venture arrangement from being viewed as a partnership, the contractual terms of the joint venture will generally specify the participant’s respective rights and obligations
- Often provides for sharing of product rather than profit
- Needs to demonstrate that the parties aren’t conducting a business in common (because that would make the arrangement a partnership)
- Legal persons getting together for a one off project
- Advantages of being an unincorporated joint venturer are:
  - Joint venturers are not agents for each other – their liabilities with respect to the debts incurred in the project, while being personal and unlimited, are several – not joint (each party treated as an independent tax payer and not as a member of a partnership)
- **Trust**
  - one party (trustee) holding property for the benefit of another (beneficiary)
  - Beneficiary is the one entitled to enjoy the property/receive the benefits
  - A trust is of itself not a legal entity
  - The trustee is personally liable (but often company as trustee) for debts incurred on behalf of the trust. The beneficiary is generally not liable for debts incurred by the trustee
  - Trusts are often used in family businesses to enable the distribution of income derived from the business to a number of beneficiaries
  - Distinctions between a trust and a company:
    - Beneficiaries under a common trust are not able to control the trust
    - Members under a company have ultimate control over the company
    - There cannot be a trust in which the trustee is the sole beneficiary. But it is possible to have a company with one member where they are also the director of the company

**Why choose a company to carry on business?**

<table>
<thead>
<tr>
<th>Advantages</th>
<th>Disadvantages</th>
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<tbody>
<tr>
<td>Separate Personality</td>
<td>Establishment and administrative costs</td>
</tr>
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<td>- Can be costly</td>
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<td>- Costs of forming a company</td>
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<td>- Costs associated with registration of a company</td>
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<td>- Company’s usually have ongoing administrative obligations throughout the company’s life</td>
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<td>- Need to maintain financial reports</td>
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<td>- Filing fees + management time</td>
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<tr>
<td>Limited liability (not the debts of its members) – limited to a pre-agreed amount</td>
<td>Publicity</td>
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<td>- All companies are required to disclose information (eg change of directors) to ASIC</td>
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<td>- Information needs to be available to the public</td>
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<td>- For small proprietary companies – the information sometime includes key financial information</td>
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<td>Perpetual succession (A company’s existence continues indefinitely, until it is brought to an end through liquidation. Shareholders can cease to be owners of the company simply by selling their shares on the market, but the company is there to stay)</td>
<td>Public law obligations</td>
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<td>- Companies must submit themselves to obligations and the public law</td>
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<td>- Under Corporations Act</td>
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<td>- Can be enforced by the state</td>
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<td>- (A breach by a director of their duty to avoid conflict may result in substantial fine or imprisonment depending on the provisions of the Corporations Act)</td>
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<td>Easier to transfer interests &gt; 20 investors (free transfer of investors interests – represented in the form of shares – capable of being traded on the markets) Must incorporate if there are &gt; 20 investors</td>
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<tr>
<td>Corporate law as standard form contract (where there is more than one participant in a business venture, the respective rights and obligations of shareholders, managers and creditors, must be agreed upon by those people. The law governing the chosen form of business association can be seen to provide standard form of terms governing</td>
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any aspects of relationships for those participants.  
Can reduce costs and uncertainty for the participants.)

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<tr>
<th>Floating charges</th>
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<tr>
<td>- Companies have the ability to give a floating charge for their assets – a form of security interest over assets</td>
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<tr>
<td>- The ability to give an investor this type of security may mean the financing may be more readily available or available at a lower cost to a company that to an unincorporated business enterprise</td>
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<th>Tax considerations</th>
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<td>- Companies are tax payers for the purpose of Australian Income tax legislation</td>
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<td>- Different business vehicles attract different tax arrangements</td>
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<td>- Companies pay company tax at a lower marginal rate than individuals in all but the lower taxation brackets</td>
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<tr>
<td>- Taxation benefits for being a company</td>
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</table>

Corporations Act inherently more flexible in accommodating for different types of investors.

Need to choose the most appropriate form of business association, which includes careful consideration of all these factors.

For larger enterprises, particularly those with the purpose raise capital from the public – a company will be the most appropriate form of business association

In small businesses, the choice may be less clear-cut. Look at the intended use and individuals needs.

- Registered company
  - Separate legal entity

**How are companies used in Australia?**

- Vehicle for raising large amounts of capital
- Incorporated joint venture – company formed to conduct a one off joint venture company
- Small business – incorporate to limit liability of the owners
- Corporate trustee – no inconvenience of having to assign new trustee when one dies
- Privatized government enterprise (Government enterprise are often conducted by commissions – sometimes these commissions are incorporated with belief that its efficiency will be improved)

**Telstra**
- Privatized by offering shares for sale to the public

**A little bit of Theory:**

- 3 main explanations of the corporate form (explains existence of corporations + used to help to define the legal rights and obligations of corporations):
  - **Concession theory**
    - Corporations owe their existence to the grant of separate legal personality by the state. The state can therefore also define the limits of corporate power
- **Aggregate theory**
  - Explains existence of corporation with their ability to allow groups of individuals to get together to pursue aims collectively. The state should encourage the use of corporate form, in particular because it is formed for the common good

- **Corporate realism**
  - This approach goes further in accepting that corporations are real persons
  - This theory is further supported by corporate culture, and corporate social responsibility and behaviour

**Historical development of company law:**

- Modern commercial company can trace its origins back to the Middle Ages where corporations aggregate emerged in England as a means of conferring to a group of people the capacity to hold and deal with a property and interests to advance their collective aims
- Medieval English law found it necessary to treat certain groups as having a legal existence (So even if individual members pass away, there is a vehicle that is here to stay)
- A corporation aggregate is an incorporated group of persons of an incorporated single person
- A corporation aggregate could only arise by the consent of the monarch (expressed in a grant of royal charter)
- The corporation existed as the beneficiary of a special right or entitlement conferred by the Crown such as a monopoly to the right to control the operation of a particular trade
- During the 7th Century, incorporation was granted by royal charter to various merchant adventurers, conferring on them, rights to trade in particular areas, e.g. The East India Company, which was authorized to trade in India and other parts of Asia (had separate legal personality)
- Alternatively, English Parliament could also create a corporation by passing a private Act (alternative to a petition to the monarch for a royal charter)
- Was not simple to incorporate – was very expensive
- 17th century also marked development of joint stock. Large commercial activities needed substantial capital that a single individual could not provide. To meet this need, a mechanism was developed whereby a person could invest a sum of money in a venture; receiving in return, an entitlement to a share of the profits of the venture. The investor’s entitlement was represented by shares. These shares were transferrable and could be sold by the investor without the consent of other investors.
- Many ventures were carried out as joint stock companies

**Case – The South Sea Bubble**

- Beginning of 18th century
- Well developed market for shares in joint stock companies
- South Sea Company formed in 1711
- Shares in this company rose from 100 pounds to 1000 pounds in a matter of days
- In 1720 busted
- Resulted in large losses and considerable hardship for middle class families in England
- In response, Parliament past legislation called the **Bubble Act in 1720**, to prohibit such associations from acting as Body Corporate, and from issuing transferable of shares without the authority of a royal charter or an Act of Parliament. As a result, this type of joint stock company became illegal.
- But incorporation by royal charter or by Act of Parliament remained very difficult to obtain.
- Larger scale ventures – such as the development of railways, demanded a means of raising capital from investors to be used by managers in these projects
- Lawyers developed ‘deed of settlement companies’ as a means of achieving these commercial aims while getting around the prohibition in the Bubble Act
Deed of Settlement Companies:
- Essentially a combination of trusts and associations
- The assets of the ventures were held on trust by trustees, and the venture itself was managed by the managers or directors.
- The venture didn’t actually possess any separate legal personality
- Its property, rights and obligations were held by the trustee
- The terms of the trust deed, which was contained in the deed of settlement, often permitted the transfer of the shares (shares are transferable)
- Attempts were made to limit the liability of the investors to the amount that was invested
- They were complex to establish
- Were ineffectually regulated by the state
- Did not have the benefit of separate legal personality

The Bubble Act was repealed - 1825
- Other means to have large ventures were explored

1844 – Joint Stock Companies Registration and Regulation Act
- Allowed business associations to become companies by a process of registration
- Under this Act, any group wishing to form a company, for a lawful purpose, could apply for registration
- And by lodging the required information, and paying the required fee, you could obtain it
- Companies registering under this Act, were corporations with separate legal personality
- But this Act did not in itself confer limited liability to participants in the company
- If the debts of the company exceeded its assets, creditors of the company could pursue individual investors once their claims against the company were exhausted

Case - City of Glasgow Bank
- When the bank collapsed, shareholders were liable on its collapse to pay about 300 pounds for every 100 pound share that they owned
- Unlimited liability demonstration (disincentive to investment)

1848-1853
- A number of attempts in NSW and Victoria to introduce limited liability as a means of encouraging business development
- NSW – The Parliament passed several Acts incorporating some of the leading banks, including the Bank of NSW (Westpac), in which the liability of investors was limited to twice the nominal value of shares held

1855 – Limited Liability Act
- English Parliament past this Act
- Companies could elect to agree to limit liability to amount investor

1862 – Companies Act 1862 (UK)
- Widespread use of companies for small business by end of 19th century
- Consolidating the procedures for incorporation and winding up of companies
- Put in place many of the key features of modern company law
- Adopted by the Australian States – mirroring the position in England

Regulation of companies in Australia (legal framework)
- In Australia’s early history: Colonies adopted English legislation
- States responsible for company law (federation 1st July 1901)
- Until 1961 states had own legislation
- 1961-2001 since 1961 there has been a steady move towards federal uniformity
How did the High Court interpret “formed within the limits of the Cwth” in s 51(xx)?

Case – 1909 Huddart Parker:
- High Court of Australia interpreted the Commonwealth power to make laws with respect to corporations formed within the limits of the Commonwealth in s 51 (xx) of the Constitution
- Only refers to corporations already formed/in existence
- As a result, the Commonwealth had no power to make laws in regards to the formation of companies
- Matters relating to the formation of companies, such as matters of registration and terms, were thus matters within the exclusive jurisdiction of the States

Today’s World:
- View that corporate regulation is a matter of national importance

2 layers of uniformity:
Uniformity of legislation:
- Actual legislative text

Uniformity of administration:
- Uniformity of administration of the law by regulatory bodies

Milestones to Uniformity:
1961: States’ Uniform Companies Acts
- Commonwealth made similar law for Territories as well

1981: Companies Act 1981 (‘the Co-operative Scheme’)
- Companies Act 1981 (Cth) – using its power under s122 Constitution to make laws for the ACT
- States enacted application Acts – the uniform State Law called Companies (name of state) Code
- National Companies Securities Commission (NCSC) and state Corporate Affairs Commissions
- Each state remained its own local administration
- NCSC made uniform policy
- New South Wales v Commonwealth (1989) 169 CLR 482

1991: The Corporations Law Scheme
- Corporations Act 1989 enacted by Commonwealth for the ACT
- This legislation provoke political debate
- Several states were hostile to it
- The Commonwealth power is one with respect to ‘formed’ corporations
- A Constitutional Challenge by NSW, SA, WA
- Text of Corporations Law – contained in one section: s82
- State and NT laws applied Corporations Law of the ACT as law of that state
- Administered by ASC/ASIC and Cth bodies (DPP, Federal Court)

2001: The Corporations Act 2001 (Cth)

Constitutional Challenges the national Corporations Law Scheme
- Re Wakim; Ex parte McNally (1999) 198 CLR 511; [1999] HCA 27 the High Court held that the cross-vesting of jurisdiction between the Federal Court and the state courts was constitutionally defective.
Resolution – Referral of Powers
States have referred to Commonwealth their legislative competence over corporations in accordance with s 51(xxxvii) Constitution.

Section 51(xxxvii) confers on the Cth power to make laws for the Commonwealth of Australia with respect to:
“…matters referred to the Parliament of the Commonwealth by the Parliament…of any State or States, but so that the law shall extend only to States by whose Parliaments the matter is referred, or which afterwards adopt the law.”

The 2001 Corporations Act Scheme:

• **Principal legislation:**
  Includes two pieces of principal legislation
  
  – **Corporations Act 2001 (Cth)**
    o Rules governing large public companies are in the same statute as the rules governing small proprietary companies
    o Includes rules regulating the conduct of securities and the future market
    o Provides for formation of Australian companies,
    o Provides for registration of foreign companies operating in Australia
    o Regulates fundraising by companies, company management, internal management, company reorganisation
    o Regulates takeovers (transferring all of the company’s shares to a different owner)
    o Regulates liquidation and winding up
  
  – **The Australian Securities and Investments Commission Act 2001 (Cth)**
    o The ASIC Act
    o Establishes and regulates the Australian Securities and Investment Commission
      o S 1(2) sets out ASIC’s statutory role.
      o SS 11-12 confers ASIC’s functions and powers –

Other Sources of company law:

Case Law

- Provides additional rules governing companies that are not contained in the Corporations Act
- Also provides binding statements governing the interpretation of the Corporations Act
- Most significant Australian decisions are published in specialised law reports
  o Australian Corporations and Securities Report
  o Australian Company Law Cases

ASIC exemptions, modifications and guidelines

- Companies may need to consider exemptions from ASIC, modifications and guidelines for interpreting the Corporations Act
- ASIC has power under the Corporations Act to modify or grant exemptions of certain parts of the Act, to individual applicants, or certain classes of applicants
- Class orders – Apply to all companies falling within the class described in the order
- The affect of ASIC in these powers is to alter the law
- ASIC is a very powerful body
- Information booklets, policy statements, practice notes – don’t have the force of law, but are a useful source of guidance for interpretation of the Corporations Act
- Practice notes – Generally set out ASIC’s interpretation of provisions of the Corporations Act
- Policy statements – Guidelines to how ASIC will exercise its powers and discretions
- Information booklets – Issued to educated companies. Advise on their rights and obligations
- Copies of the practice notes, policy statements and information booklets are all available on ASIC’s website

**Accounting standards**
- Companies are required to keep financial records
- Some companies must prepare financial reports, have them audited, lodge them with ASIC and have copies sent to its shareholders
- S 296 Corporations Act requires the financial report to comply with accounting standards
- Accounting Standards are defined in Part 2M.5 of the Corporations Act
- Standards made by the Australian Accounting Standards Board (established under the ASIC Act)

**ASX listing rules**
- Some companies are listed companies (their shares listed on a public stock exchange)
- ASX – Australian Stock Exchange
- ASX is a market, it is also a private company
- Provides a trading facility for securities issued by companies listed on its stock exchange
- Listing means that securities can be bought and sold on the market
- ASX is only one of the markets
- When companies list, they agree, as part of a contract with ASX, that they will comply with the rules that are the ASX listing rules. These rules are in addition to those included in the Corporations Act
- The purpose of the listing rules is to ensure that the market for listing company’s securities is transparent, liquid and informed (inform the public)
- ASX listing rules only apply to listed companies (essentially act as private law that is binding between the ASX and the listed company)

**The Regulators of Companies:**
- **ASIC**
  - The Minister responsibility for overseeing the ASIC’s function is the Commonwealth Treasurer
  - Main regulator and responsible for administrative functions under CA and ASIC Act
  - Registers companies
  - Gathers and maintains public record of information
  - Education
  - Modifications and exemptions from CA
  - Registers auditors and liquidators
  - Investigates suspected breaches of CA. Enforces CA
  - **Objectives of ASIC – S 1(2) ASIC Act:**
    - Maintaining, facilitating and improving the performance of the financial system and the companies, and other entities within the system, in the interests of commercial certainty
    - Reducing business costs
    - Efficiency and development of the economy
Promoting the confident and informed participation of investors and consumers in the financial system

ASIC’s main functions in relation to the regulation of companies are:
- To register companies
- To investigate/inspect the breaches of the Corporations Act
- To enforce the Corporations Act

- **ASX**
  - The largest public companies can choose to have their shares listed with the Australian Securities Exchange (ASX): [www.asx.com.au](http://www.asx.com.au)
  - Not a government mentor or regulatory agency
  - The ASX operates a stock market in which shares of listed companies can be easily bought and sold
  - Companies listed on ASX have contractual obligations to ASX to comply with Listing Rules:
    - ASX may provide info to ASIC about listed companies
    - ASX must notify ASIC of breach of listing rules or CA

- **Courts**
  - Matters other than CA (arising outside the CA) – ordinary jurisdictional rules
  - Matters arising under CA
  - If ‘Court’ in CA – matter must go to Federal Court and Supreme Court of the State
  - If ‘courts’ – refers to courts generally and includes lower courts (S 58(AA))

**Corporate Social Responsibility:**
- **What is CSR?**
  - Deliberate inclusion of public interests in corporate decision making
  - Company takes into account the impact of its activities on stakeholders (business approach)
- **Key concepts**
  - Stakeholders: shareholders (who have a direct acting interest in the company)/creditors (with financial interest in the company)/suppliers/employees/consumers/community – *The conduct of companies can affect a broader range of people that just shareholders.*
    - Groups or individuals that can reasonably expect to be substantially affected by an organization’s activities.
  - Sustainability:
    - Sustainable development is a form of development that meets the needs of the present without compromising the ability of future generations to meet their own needs.
    - This definition is based on the view that economic development can only be achieved by integrating environment and social concerns with economic outcomes

**Telstra Corporation Limited v Hornsby Shire Council (2006) NSWLEC 133**
- Explores sustainable development (Justice Preston)

**UK’s position:**
- Has incorporated the idea of corporate social responsibility into its legislation
- Elaborated shareholder benefit approach
- s 172, UK Companies Act 2006
  > Duty to promote the success of the company.
  > Requires directors to consider a range of relevant employees, and social and environmental considerations in fulfilling their duties to the company and its shareholders.
  > Director of the company must act in good faith + fairly as between members of the company.

**Australia’s position:**
- The idea of corporate responsibility, has never been incorporated into any Australian legislation.

**Companies and Markets Advisory Committee (CAMAC) released the report - **The Social Responsibility of Corporations** (2006)
  - Considered that amendments to director’s duties in the Corporations Act 2001 were not necessary.
  - Felt that the current Commonwealth and statutory requirements were sufficiently flexible to enable directors to take relevant community and other stakeholder considerations into account in their decision making process.
  - Felt that amendments to director’s duties might actually be counter productive in that the role of directors could become more difficult, and their accountability to shareholders could become less certain.

**Parliamentary Joint Committee on Corporations and Financial Services - **Corporate Responsibility: Managing Risk and Creating Value** (2006)
  - Directors' duties;
  - Recommended that reporting on social and environment impact of companies should not be mandatory but should be strongly encouraged.
  - Were concerned that mandatory reporting and social and environmental impact would tempt corporations to only comply with the minimum standard and nothing more.
  - Reporting on the social and environmental impact of company activities.
  - Idea of corporate social responsibility hasn’t been incorporated in any legislation in Australia.

**TOPIC 2: REGISTRATION AND ITS EFFECTS**

- A company incorporated under the Corporations Act 2001, comes into existence on the day as a body corporate at the beginning of the day on the day it is registered s 119 CA.
- ASIC as an agent for the government, creates a legal entity/person that is a company when it registers the company following an application made by a person s 117 CA.

By stating that a company comes into existence as a body corporate, s 119 CA, impliedly states that the company comes into existence with the attributes given by the common law to a body corporate. – Except so far as the Corporations Act modifies or supplements those attributes/qualities.

- The attributes/qualities given by the common law to a corporation by the late 18th century were:
  - The power to sue or be sued in the corporate name.
  - Perpetual succession.
  - The power to have a common.
The power to hold property in the corporate name
- The power to make rules for the internal government of the corporation

S 124 (4) CA – gives a registered company the legal capacity and powers of an individual, and or the powers of a body corporate

The functions of a company are carried out by those people authorized to act on behalf of the company – directors, employees and possibly other

Attributes of a Registered Company:
- **Powers of natural person plus ‘corporate powers’**
  - Can enter into contracts and liabilities in own name (companies obligations are its own)
  - Can sue and be sued in own name
  - Acquire, hold and dispose of assets in own name (company continues to own the property even if the identity of its employees and directors changes)
  - Perpetual succession (continues to exist despite changes to its membership, only ceases to exist when it is deregistered through statutory procedures)
  - Has the power to issue and cancel shares (nature legal persons cannot do so)
  - Has power to grant a floating charge (as security for loans)

**Limited Liability:**
- Limited liability: Business people, entrepreneurs and investors are seeking to protect themselves against any financial risks associated with business ventures are able to limit their liability in a number of ways

Can limit liability by:
- Contract (contractually can state that are limiting their liability)
- Insurance (to cover their losses)
- Incorporating as a limited liability company

**Company limited by shares** – member’s liability limited to amount unpaid on shares held: s 9 and s 516

Limited liability is not an inevitable feature of incorporation. Companies with limited liability did not come into existence until 1851.

- If you incorporate, it does not necessarily mean that you have the benefit of limited liability
- In a company limited by shares, under the idea of limited liability, the liability of members to contribute to the payment of the company’s debts and liabilities is limited to the amount, of any shares respectively held by them.

- **S 9 + S 516**

**Economic arguments for limited liability include:**
1. Decreases investors’ need to monitor management
   - Because personal assets of investors are not at risk, beyond the extent of their investment, it decreases their need to monitor management
2. Provides incentives to manage company effectively??
   - Because of limited liability we have professional managers – shareholders are not normally involved in the day-to-day running of the company. It is presumed that those professionals are good at managing the company.
   - On the other hand, it could also be argued that it is an incentive to improve management
   - Because of lack of investor oversight managers will work to maximize their own interests (agency problem)
Disadvantages – risk largely shifted to creditors to the public?

There were some who thought the principal of limited liability was immoral
  - The risk of business failure is largely on the creditors (if the company goes bust - whether you get paid as a creditor depends on whether the company has enough funds to cover all the claims against it in its liquidation – normally it doesn’t)
  - Unsecured creditors can be left unpaid, or be paid only a fraction of what they are.
  - Some creditors however can protect themselves against this risk, by contracting with the company in certain ways (e.g. by restricting the dividend policy)
  - Most of creditors however cannot be protected in these manners

To some extent, some risk is also shifted to the public (bank situation)
  - Public money/tax payers money has to be channelled to support bank
  - This is called a privatization of profits, and externalization of losses – as a result of limited liability
  - If there is a profit it goes to the owners/shareholders of the company. But if there are losses – they are shared by external parties, like creditors, and in the bank’s case – taxpayers

Separate Legal Entity Doctrine: (a separate legal doctrine of company law)
  - A company is a legal entity separate from the persons who associated for its formation or who are now its members
  - “Corporate veil” created on incorporation – separates company from members
    o Corporate veil comes into existence when the company was incorporated
    o Separates the company from the people who formed it, and from those who become its members
    o The separate legal personality of a company means that any rights that a company and any of its obligations, are the rights and obligations of the company (and not those of its managers, employees or investors)
    o This idea of the separate legal entity doctrine existed before registered companies – and it was applied to common law corporations

In relation to registered corporations, the implication of a company being a separate legal person is illustrated in:

Salomon v Salomon & Co Ltd
  o Mr Salomon had managed to build up a considerable business manufacturing leather and shoes. Initially, he conducted his business as a sole trader
  o In 1982, he decided to establish a limited company
  o Company’s Act 1862 UK – enforced at the time – required a minimum of 7 associated persons before a new company could be registered
    o But, under the Corporations Act, it is possible to register a new company with only one member
  o Mr Salomon gave one share each to his wife, and 5 of his children
  o None of his family had any real interest in the company
  o He himself transferred the existing business in the form of sole trader in the form of 20,000 fully paid shares, and also secured the venture to the value of 10,000 pounds. The venture was secured against the company’s assets
  o Mr Salomon was both the dominant shareholder in the company, and a significant secured creditor
  o Mr Salomon furthermore retained full control of the business by appointing himself as a managing director of the company, and entering into an agreement with his family
members that said that they would exercise any of their managing powers in accordance with his wishes

- The company fell into financial difficulties, and the company left debts of 77,000 pounds
- Mr Salomon’s secured debt in the form of the debentures would be paid in priority of other unsecured creditors.
- A liquidator was appointed, and the liquidator brought an action on behalf of the unsecured creditors against Mr Salomon to indemnify the liquidator for the unsecured debts of the company
- It was argued that the company was a mere agent or an alter ego of Mr Salomon and that Mr Salomon as the principal was under the obligation to the company to indemnify it
- Under agency law principal – an agent’s loss is normally indemnified under this principal.
- It was further argued that the transfer of the business and the issue of the debentures to Mr Sullivan were based on fraud and therefore invalid
- The judge in the first instance and the court of appeal held that:
  - Limited liability did not extend to what was in effect a one person company
  - While the judge in the first instance regarded the company as an agent for Mr Salomon, the Court of Appeal preferred to base this decision on arguments that the company was formed for an illegal purpose
  - It was said that the legislature, never intended that the company should exist for one substantial person and 6 mere dummies – the nominees of that person (without any real interest in the company)
  - To legalise such a transaction would therefore be a scandal
  - On appeal, the House of Lords unanimously reversed that decision.
  - The House of Lords held that the company was not an agent, was not an alter ego or trustee of Mr Salomon, and that in the absence of fraud – the principal of separation between company and its controllers applied – even in cases, such a here, where one person owns the vast majority of the shares and controls the company.
  - Salomon’s gave acceptance to the one person company
  - Does not require a group of independent investors
  - After this case, any sole trader could obtain limited liability through incorporation by enlisting dummies or nominees to make up the minimum number of 7 associates

- This case fostered the development of what became known in Australia as the $2 company
- If it was a proprietary company with only 2 members, each of them subscribing $1 for a $1 share in the company

**The Consequences of Separate Legal Entity Doctrine:**

- A company’s property is its own and not the property of its owners
- The company’s owners/shareholders have no priority legal or equitable interest in the company’s property – no ownership rights in respect to the property
- **Macaura v Northern Assurance Co Ltd [1925] AC 619**
  - Mr Macaura transferred his interests in a timber plantation to a company controlled by him
  - He had insured the timber in his own name, but failed to transfer the insurance policy to the company
  - So the timber remained insured in his own name
  - When the timber was destroyed by fire, the insurance company refused to pay up under his policy, because he did not have an insurable interest in the property as he was not its owner
  - He is not the owner, so the insurance company will not pay
  - The company was the owner of the timber – not Mr Macaura
  - The insurance company’s refusal to pay was upheld by the House of Lords
Overturned by the Insurance Contracts Act 1984 (Insurance Law)
- But this case remains authority for the proposition that property owned by companies is not owned by its members

- Company’s right of action is not a right of action of its shareholder. The company’s lawsuit is not the shareholder’s lawsuit.
- If a company makes a contract it is the company that is the party to the contract, not its directors or members. If a third party knows that they are negotiating with agents, and then enters into a contract with the company, it will be the company that is liable for any breach of contract (rather than any agent, or director or member)
- Company can contract with its controlling member

**Lee v Lee’s Air Farming Ltd [1961] AC 12**
- Controlling member/managing director held to have valid contract of employment with ‘his’ company.
- Mr Lee formed a company for the purpose of carrying out a business of aerial spraying crops
- He held all of the 3000 issued shares of the company with the exception of one
- He was also the governing director of the company for life
- He was also appointed as a chief pilot of the company, with a salary arranged by himself
- The company constitution also provided that in respect of such employment, a relationship of master and servant should exist between him and the company
- Mr Lee was killed while piloting the company’s aircraft in the course of aerial spraying
- His widow claimed compensation
- The Privy Council followed the law of established corporate law principals – In particular the Separate Legal Entity Doctrine in this case. On that basis, it was decided, that a person, even where he is the controlling shareholder, and also the managing director of the company, was able to enter into a valid employment contract with the company.
- Mr Lee was therefore an employee of the company and Mrs Lee could claim compensation

- Company can be a debtor or creditor of a member
- Members can lend to and borrow from company – loan accounts common in proprietary companies
- **Salomon’s case**
  - Mr Salomon extended 19,000 pounds as a loan to the company
- Company can act as guarantor for member and vice versa (for the debts or obligations)
  - Banks often seek extra security for loans to companies
- Company and natural person as accomplices
  - **Hamilton v Whitehead (1988) 166 CLR 121**
- Company is taxpayer on its own income
  - Must pay company tax on its income

**Piercing/Lifting the Corporate Veil – How?**
- Why would you want to lift the veil?
  - Sometimes people form a company to use the corporate veil as a shield to protect them from personal liability
• Outsiders may want to have the veiled lifted or pierced in order to get access to the assets of those responsible for the company’s business operations

**Veil may be lifted in 2 ways:**
1. Under a specific statutory provision
2. Under general law principles

Sometimes veil is lifted to advantage of the company’s controllers – reverse lifting

**Smith, Stone & Knight Ltd v Birmingham Corporation**
- The parent company argued successfully that the subsidiary should be treated as carrying out its business as agent to the company – entitling the parent company to receive compensation for disruption to its business when the premises of which the business was conducted on was acquired by the defendant on a compulsory basis

These principles and provisions have developed in response to abuses of this Limited Liability Doctrine

**Statutory Examples:**
Statute may contain an express provision, which imposes liability or penalty on the directors or controllers of a company

Under Corporations Act, examples are:
- **Insolvent trading provisions** (occurs where the company continues to trade and incur debt even though there are reasonable grounds to expect that a company is insolvent), ss 588G – 588M suspect co will not be able to pay debts (directors); ss 588V-588W (holding companies)
  - Defences are outlined in ss588H – if can’t prove directors are exposed to personal liability for the company’s debts
  - Insolvent – when the company can’t pay its debts
- **Financial assistance**, s 260D(2)
  - If a company provides financial assistance for the purpose of its own shares, in breach of s 260A, it is the person who is involved in the company’s contravention who is liable – not the company itself
- **Un-commercial transactions**, ss 588FB-588FF
  - Certain transactions that occur within two years prior to a company going into liquidation, are voidable as against a liquidator
  - The court has wide powers to order compensation by the party who is normally the director who has received the benefits of the un-commercial transactions
- **Company officer charges**, s 267 – officers of the company who are granted charges for debts owed to them by the company, cannot enforce their security within 6 months unless they have leave of court

**Duty to Avoid Insolvent Trading (s 588G)**

1) A person is director at the time co incurs the debt;
2) At that time, co is insolvent or becomes insolvent by incurring that debt;
3) At that time, a reasonable person would have grounds to suspect that 2).
4) At that time, the director is, or a reasonable person in similar circumstances would have been, aware of 3)

**General Law Approach:**
- Separate personality of company cannot be taken away by court – but in some cases, court may lift veil