COMMERCIAL APPLICATIONS OF COMPANY LAW 2020

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GEOF STAPLEDON

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COMMERCIAL APPLICATIONS OF COMPANY LAW

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PREFACE

Commercial Applications of Company Law is an integrated teaching and learning resource designed especially for the study of company law by business students.

The book is written by two leading corporate law academics and the Vice President Governance for BHP, one of the world's largest companies. The authors have significant legal, business and regulatory experience. The book explains the core principles of corporate law in a straightforward (but not simplistic) way and illustrates the application of those principles by reference to important case law. In addition to dealing with the 'four pillars' of company law — corporate legal personality, corporate management and governance, corporate finance and corporate liability — the text also includes chapters introducing the related areas of securities and takeover law, financial services regulation, and corporate insolvency.

The text is supplemented by three valuable teaching and learning resources — case studies and problem sets, sample company documents, and extracts from the legislation.

The case studies and problem sets provide two running case studies, involving a listed public company and a small proprietary company. As students progress through the course, the problem sets provide an opportunity to apply the principles explained in the commentary to real-life situations involving these different types of companies.

The sample company documents include examples of corporate documents (such as a corporate constitution, a notice of meeting, minutes of meetings, and ASIC filings) used in the case study. The legislation section includes relevant provisions from the *Corporations Act 2001* (Cth) and the *Australian Securities and Investments Commission Act 2001* (Cth) that are discussed in the text.

The 21st edition provides the most up-to-date treatment of law and regulatory practice in this area, incorporating developments up to October 2019. This includes the significant shift in corporate governance thinking in Australia following the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry.

While the book is a collaborative effort, responsibility for the different chapters is allocated as follows. Pamela Hanrahan wrote Chapters 1–8, 17–20 and 22, and parts of Chapter 21. Ian Ramsay wrote Chapters 9–16 and ¶6-130. Geof Stapledon wrote Chapters 23–25, ¶2-400, ¶3-500 to ¶3-540, ¶6-120 to ¶6-140 and ¶21-200 to ¶21-420.

Pamela Hanrahan
Ian Ramsay
Geof Stapledon
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Pamela Hanrahan is a Professor and Deputy Head of the School of Taxation and Business Law at the UNSW Business School, Sydney, and a Senior Fellow of the Melbourne Law School.

Pamela has published extensively in the areas of financial services law, securities law and corporate governance. Her books include *Securities and Financial Services Law*, which is Australia's leading securities law book (co-author, 9th edn, 2017); *Contemporary Issues in Corporate and Competition Law: Essays in Honour of Professor Robert Baxt AO* (co-editor, 2019); *Corporate Governance* (co-author, 2017); *Managed Investments Law & Practice* (looseleaf, 1998–); *Funds Management in Australia: Officers' Duties and Liabilities* (2007); *Commercial Applications of Company Law in Singapore* (co-author, 5th edn, 2015); *Commercial Applications of Company Law in New Zealand* (co-author, 5th edn, 2015); and *Commercial Applications of Company Law in Malaysi*a (co-author, 3rd edn, 2008).

Pamela has practised as a commercial solicitor for many years and is a former Regional Commissioner of the Australian Securities and Investments Commission. She holds Honours degrees in Arts and Law from the University of Melbourne, a Masters degree (with Honors) from Case Western Reserve University in the United States, and a Doctorate of Juridical Science from the University of Melbourne.

She is a Fellow of the Financial Services Institute of Australasia, and a member of the executive of the Business Law Section of the Law Council of Australia and of the Society for Investment Law (USA).

PROFESSOR IAN RAMSAY

Ian Ramsay is the Harold Ford Professor of Commercial Law and also Redmond Barry Distinguished Professor in the Law School at the University of Melbourne where he is Director of the Centre for Corporate Law and Securities Regulation. He has practised law with the firms Sullivan & Cromwell in New York and Mallesons Stephen Jaques (now King & Wood Mallesons) in Sydney.

Other positions Ian currently holds or has previously held include:

- Associate Dean, Masters Program, Melbourne Law School, The University of Melbourne (2005–2010 and 2013)
- Dean, Melbourne Law School, The University of Melbourne (2002–2003)
- Director of the University of Melbourne's Centre for Corporate Law and Securities Regulation (1996 to date)
- Chair of the Independent Panel appointed by the government to review the financial system's external dispute resolution and complaints framework (2016–2017)
- Member of the Australian Securities and Investments Commission Enforcement Review Taskforce (2016–2017)

- Consultant to the Association of Southeast Asian Countries (ASEAN) and co-author of the report for ASEAN on facilitating equity crowdfunding in ASEAN (2016–2017) Member of the Capital Markets Advisory Group of the Securities Commission of Malaysia (2013–2015)
- Member of the Corporations and Markets Advisory Committee (which was the Federal Government's main corporate law reform advisory body) (2002–2014)
- Member of the Takeovers Panel (which is the main forum for resolving takeover disputes) (2000–2012)
- Member of the Australian Securities and Investments Commission External Advisory Panel (2009–2013)
- Member of the Corporations Law Committee of the Law Council of Australia (1995 to date)
- President of the Corporate Law Teachers Association (2000–2001) and member of the Executive Committee of the Corporate Law Teachers Association (1995–2014)
- Member of the National Law Committee of the Australian Institute of Company Directors (1995–2011)
- Director of the Audit Quality Review Board (2006–2009)
- Member of the Federal Government's Companies Auditors and Liquidators Disciplinary Board (2004–2013)
- Member of the Appeals Commission of the Federation of International Basketball Associations (2002–2014)
- Consultant to the Scrutiny of Acts and Regulations Committee, Parliament of Victoria (2008)
- Member of the Federal Government's Implementation Consultative Committee for the Financial Services Reform Act (2001–2005)
- Consultant to the Australian Broadcasting Authority (ABA) and author of the report for the ABA on reform of the ABA's enforcement powers (2004)
- Consultant to the Victorian Government on corporate law reform (2000, 2003 and 2007)
- Consultant to the Parliament of Australia House of Representatives Standing Committee on Economics, Finance and Public Administration (2004)
- Member of the International Federation of Accountants taskforce on rebuilding confidence in financial reporting (2002–2003)
- Consultant to the Australian Securities and Investments Commission (ASIC) and author of the report for ASIC on disclosure of fees and charges in superannuation and other managed investments (2002)
- Head of the Federal Government's inquiry on auditor independence (2001)
- Member of the Australian Law Reform Commission's Advisory Committee for its civil and administrative penalties project (2000–2002)

- Member of the Australian Securities and Investments Commission's Corporate Governance Roundtable (1998–2002)
- Visiting Professor, Faculty of Law, The University of Paris (2008)
- Distinguished Visiting Professor and Professorial Fellow, Faculty of Law, The University of Hong Kong (2001)
- Distinguished Visiting Professor, Faculty of Law, The University of Toronto (1997)
- Member of the Executive Committee of the Business Law Section of the Law Council of Australia (1990–1999)
- Consultant to the Australian Law Reform Commission for its managed investments project (1992)
- Deputy Director of the Federal Government's Companies and Securities Advisory Committee where he wrote a number of reports including a report on directors' and officers' insurance (1991–1992)

Ian has published extensively on corporate law and corporate governance issues, both internationally and in Australia. His books include *Ford, Austin and Ramsay's Principles of Corporations Law*, which is Australia's leading corporate law book (co-author, 17th edn, 2018); *Incentivising Employees: The Theory, Policy and Practice of Employee Share Ownership Plans in Australia* (co-author, 2013); *Law, Corporate Governance and Partnerships at Work: A Study of Australian Regulatory Style and Business Practice* (co-author, 2011); *The Takeovers Panel and Takeovers Regulation in Australia* (editor, 2010); *Varieties of Capitalism, Corporate Governance and Employees* (co-editor, 2008); *Commercial Applications of Company Law in Singapore* (co-author, 5th edn, 2015); *Commercial Applications of Company Law in New Zealand* (co-author, 5th edn, 2015); *Commercial Applications of Company Law in Malaysia* (co-author, 3rd edn, 2008); *Company Directors: Principles of Law and Corporate Governance* (co-author, 2005); *Experts' Reports in Corporate Transactions* (co-author, 2003); *Key Developments in Corporate Law and Trusts Law: Essays in Honour of Professor Harold Ford* (editor, 2002); *Company Directors' Liability for Insolvent Trading* (editor, 2000); *Securities Regulation in Australia and New Zealand* (co-editor, 1998); *The Corporate Law Economic Reform Program Act Explained* (co-author 2000); *The New Corporations Law* (co-author, 1998); *Corporate Governance and the Duties of Company Directors* (editor, 1997); and *Education and the Law* (co-author, 1996).

In addition, he has published over 250 research reports, book chapters and journal articles. His publications have been cited by the High Court of Australia, the Federal Court of Australia, the Courts of Appeal of the Supreme Courts of New South Wales, Victoria, Queensland and Western Australia, as well as by the Full Court of the Supreme Courts of South Australia.

His publications have also been cited by courts outside Australia including by the Supreme Court of the United Kingdom, the United States Bankruptcy Court, the Court of Appeal of New Zealand, the High Court of New Zealand, the Court of Appeal of the High Court of Hong Kong, the Court of Appeal of the Supreme Court of Singapore, the High Court of Malaysia and the Scottish Court of Session (the supreme civil court in Scotland).

Ian is a respected commentator in the media on corporate governance and corporate law. He is regularly interviewed in the financial press and has been interviewed for international newspapers including the *New York Times*. His research has been reported in international newspapers including the *Financial Times* and the *Wall Street Journal*. Ian has been interviewed on major TV programs such as the *7.30 Report* and *Lateline*, as well as radio programs including the *Law Report* and various current affairs programs.

Ian has been subject coordinator for Corporate Law taught to business law students at the University of Melbourne.

DR GEOF STAPLEDON

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During that period he also carried out several consultancies in the governance field for public- and private-sector clients. He has also worked as a lawyer specialising in corporate advisory and transactions. His book *Institutional Shareholders and Corporate Governance* was published by Oxford University Press in 1996. Geof has been a member of the Business Consultative Panel of Australian Securities and Investments Commission and the Editor of the *Company and Securities Law Journal*. He has degrees in Economics and Law from the University of Adelaide, and a doctorate from the University of Oxford, and is a Fellow of the Chartered Institute of Secretaries (FCIS).

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Victoria for case extract; **Reserve Bank of Australia** for permission to include graphs from Bulletin September Quarter 2010. http://www.rba.gov.au/publications/bulletin/2010/sep/pdf/bu-0910-4.pdf; **Wolters Kluwer**, CCH for Extract from *Australian Company Law Cases* (ACLC).

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PART A

COMPANIES AND COMPANY LAW

CHAPTER 1

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[¶1-001] Introduction

This book is about company law and how it works to create companies, to organise the relationships between participants in companies (including the directors and other corporate officers, and the company's members), to facilitate the raising of capital by companies to carry on their activities, and to give legal effect to dealings between companies and others, such as their creditors and the people with whom they contract. Companies are the most significant form of business organisation in Australia and in most other developed economies. This Chapter introduces some of the basic features of companies. The first part looks at companies as a form of business association and explains the difference between public listed companies and unlisted (often privately owned) companies. The second part provides an overview of the structure or architecture of companies. It describes in very general terms some of the key features of companies. The third part explains the historical development of companies. The fourth part explains something of the current debate about corporate purpose. The final part defines some of the important concepts discussed throughout this book.

[¶1-050] What is a company?

A company is an artificial person created by the law. The function of a company in a legal sense is to hold assets (property) and to carry on a business or other activity, as an entity separate from the participants (investors, managers) in that business or activity.

Companies come into existence through a process of registration. A person or group who wishes to use a company to carry on a particular activity makes an application to the Australian Securities and Investments Commission (ASIC), the Commonwealth government agency responsible for the formation and regulation of companies, for the registration of a new company. Provided all the conditions for registration are met, ASIC will exercise its power to create a new company by registering it. The process of registration is discussed in detail in Chapter 5. A company's existence comes to an end when it is de-registered. De-registration is discussed in Chapter 25.

COMPANIES AS A FORM OF BUSINESS ORGANISATION

[¶1-100] Introduction

A company is a type of corporation. The terms ***corporation*** or ***body corporate*** are general ones, used to describe all artificial legal entities that have the attribute of separate legal personality. What is meant by separate legal personality? This phrase is defined in ¶3-100. In brief, it means that a company is treated as a separate person from those who participate in the company. Because it is a separate person, it has its own legal identity or personality, which means that it can, for example, hold property in its own name and enter into contracts in its own name. It can commence or defend legal proceedings in its own name. Importantly, its liabilities are its own and not those of its members or officers.

Most corporations that are used to carry on business in Australia are ***companies***, that is, corporations formed or treated as being formed by being registered under the *Corporations Act 2001* (Cth) (Corporations Act).[1] Companies are the focus of this book, because they are the most common and economically significant form of corporation.[2]

Historically, commercial companies developed as a means of allowing a number of people to pool their resources (in the form of capital or management skills) to undertake an enterprise too large for a single individual. Creating a separate legal person to hold and incur the rights and obligations of the enterprise simplified dealings between the enterprise and those with whom it conducted business.

With the introduction of limited liability in the middle of the 19th century, certain types of companies[3] also provided a way for participants in an enterprise to limit the extent to which their own personal wealth was put at risk if the enterprise failed. Limited liability is discussed in detail in ¶3-300. In brief, limited liability means that even if a company is unable to pay all of its liabilities, then those participants who have invested money in the company are not liable to contribute any more than what they have paid (or agreed to pay) to acquire their shares in order for the company to meet those liabilities. Because liabilities incurred in running the enterprise are the company's own, and not the participants', the participants generally would not be required to provide any more than their initial or agreed contribution to the company to meet those liabilities.

Company law developed alongside the company to regulate the relationship between:

- participants in the company
- the company and the state
- the company and those with whom the company had dealings.

The development and structure of company law is discussed in detail in Chapter 2.

Although one of the key drivers of the development of companies was to simplify the participation of large numbers of people in a collective enterprise, the special characteristics of companies (in particular, the limited liability conferred on participants) also made the corporate form attractive to those engaged in small business. Traditionally, the law required that corporations have more than one member, but it is now possible to incorporate a company with only one member. This means that it is possible for a single individual to form a company and conduct his or her business or other activity through that company, obtaining the benefits that flow from using that form of organisation.[4]

In Australia, companies are used for both large and small business.

1 The Corporations Act is the statute that governs the formation, conduct and termination of companies in Australia. It is discussed in Chapter 2.

2 The differences between companies and other types of corporations are discussed in Chapter 4.

3 In particular, companies limited by shares.

4 The advantages and disadvantages of using a company to carry on a business are discussed in Chapter 4.

[¶1-120] What are companies like?

There are more than 2.7 million Australian companies. More than 99% of these are companies limited by shares.

What do these companies actually look like? Some are very large, with billions of dollars in assets and hundreds of thousands of shareholders. Often, shares in these large public companies are quoted on the Australian Securities Exchange (ASX), so that they can be bought and sold through the ASX by investors. The largest entity listed on the Australian market is the Commonwealth Bank of Australia, which in November 2019 October had a total market capitalisation of more than $139 billion.

There are about 2,250 Australian entities listed on the ASX. That is a very small percentage of companies overall (about 0.1%). But these large listed companies are very significant in the Australian economy. The total market capitalisation of Australian companies listed on the ASX as at September 2019 was $2,109,097 million. Of that, almost half is made up of the largest 20 companies.[5]

However, the vast majority of Australian companies by number (almost 99.9%) are not the large listed companies we read about in the newspaper. While there are many unlisted companies that operate substantial businesses, most unlisted companies are very small and have only a few participants.

Statistics collected by the Australian Taxation Office (the ATO) offer a picture of what companies look like and what they are used for. The most recent statistics indicate that, in 2016/17, a total of 969,958 companies lodged tax returns in Australia. Based on company income:

- 14% had total income equal to or less than $0
- 77% were micro-companies (with income of between $1 and $2 million)
- almost 7% were small companies (with income of between $2 million and $10 million), and
- 2% were medium companies (with income of between $10 million and $100 million).

Large and very large companies, with total income exceeding $100 million, accounted for only 0.3% of the total number of companies.

Despite accounting for only 0.3% of the total number of companies, large and very large companies paid about two-thirds of company tax. Company income tax makes up about 20% of all tax collected in Australia.[6]

[¶1-140] What are listed companies, and who invests in them?

As noted above, some companies have their shares or other securities listed for quotation on the ASX. The ASX is one of three listing markets in Australia and is the most significant in terms of scale. If a company is listed on the ASX, investors can buy and sell the company's shares on the stock market conducted by the ASX (or, from November

5 www.asx.com.au/about/historical-market-statistics.htm.

6 ATO *Taxation statistics* 2016-176 <www.ato.gov.au>.

2011, ASX listed securities on the market operated by Chi-X). As at September 2019, there were 2,096 entities with tradeable equities listed on the ASX; this included 1,955 Australian companies.[7]

Who owns the shares in listed companies?

According to the Reserve Bank of Australia, about half of Australian listed securities and bonds are owned by foreign investors. Domestic institutional investors, such as superannuation funds, managed investment schemes, insurance companies and other investment entities own most of the remaining issued securities, and retail investors, a relatively small portion (see ¶7-120).

Larger listed companies will generally have at least several thousand shareholders and, in the case of Australia's largest companies, may have many more. But the majority of listed companies by number are actually quite small, with a market capitalisation of less than $10 million, and may have far fewer shareholders. So there is significant diversity even between listed entities.

The Australian Share Ownership Study released by the ASX in July 2015 shows that 6.48 million Australians, or 36% of the adult Australian population, were invested in the Australian sharemarket, either directly (via shares or other listed investments) and/or indirectly (via unlisted managed funds) in 2014. While small shareholders comprise the vast majority by number of shareholders, between them they hold a relatively small percentage of the total shares on issue. This is very significant because it indicates that large (generally institutional) shareholders 'control' Australian listed companies.

The process of listing and its effect are discussed in greater detail in Chapter 4.

THE ARCHITECTURE OF COMPANIES

[¶1-200] Introduction

As the above discussion indicates, companies come in a great variety of shapes and sizes. However, companies formed and operating under Australian law have, for the most part, a common architecture or structure. All companies must have at least one member. In the case of a company limited by shares, the member will hold a share or shares in the company. All companies must also have at least one director, who is responsible for managing the company's business. Most proprietary companies and all public companies have a secretary, who has certain administrative responsibilities to fulfil. Larger companies may also have other officers involved in management.

The following summarises these key features and discusses the architecture of companies: their capital structure, their management structure and their legal attributes.

7 ASX Historical Market Statistics <www.asx.com.au/about/historical-market-statistics.htm>.

[¶1-220] How is a company's capital structured?

In most cases the commercial activities of companies require the use of a fund of money or property that belongs to the company. The sources of that fund (referred to in general terms as the company's ***capital***) are:

- contributions of capital made by the persons who form the company and persons who become members after the company is formed
- amounts of credit advanced to the company by creditors, including those who lend money to the company and those who supply goods and services on credit
- profits (if any) not distributed to members.

These sources of capital are discussed in greater detail in Chapters 18, 19 and 20.

What is equity capital?

The capital contributed by the members of the company is sometimes referred to as ***equity capital***. In the case of a company limited by shares, the members provide money or property to the company and receive a ***share*** or ***shares*** in return.

What is a share?

The share represents a number of rights that may or may not (depending on the terms of issue of the share) include control rights (such as voting rights and rights to receive information) and distribution rights (such as a right to receive dividends or to share in the assets of the company on a winding up of the company).

Once the person has paid money or transferred property to the company and a share is issued in return, the money or property becomes the property of the company and not of the member.

A company can issue different ***classes of shares***, with different rights attached to each class. Examples of classes of shares include preference shares and ordinary shares. Classes of shares are discussed in Chapter 19.

What does it mean to be a member of a company?

A person who holds shares in a company is a member of the company. Members of companies have particular rights in relation to the administration of the company's affairs that depend on the law and the terms of issue of the share.

The company's members are, generally speaking, its owners or proprietors. They are the people who have invested money with the company in the expectation that they will receive a return on their money if the company is successful, either in the form of distributions (dividends) paid out by the company during its trading life or in the form of growth in the value of their investment in the company over time. In the case of a company limited by shares, the members are the company's shareholders — the people who have purchased shares in the company.

Any legal person can be a member of a company. This means that the member does not have to be a natural person (that is, a human being) but may itself be a company. This is particularly the case in business enterprises structured as corporate groups. Corporate groups are discussed in Chapter 4.

It is possible to form and operate a company with only minimal paid up capital. Sometimes the total amount subscribed for shares may be as little as $1.00.

What is debt capital?

Another important source of capital for companies is ***debt capital***. Like any other legal person, companies are able to borrow money, and typically a company may borrow money from a bank or other credit provider to fund its operations. The loan may be secured (by a charge over some or all of the company's assets or business) or unsecured. Suppliers may also supply goods and services to companies on credit.

Persons who lend or advance credit to companies are not members of the company. Instead, they are in a contractual relationship with it. However, company law does contain particular provisions that affect the relationship between debtor and creditor where the debtor is a company. These include rules designed to protect the interests of creditors when the company becomes insolvent (that is, when the company is unable to meet its debts when they become due for payment).

[¶1-240] How is a company's management structured?

Managing companies involves decision-making. That decision-making may include:

- deciding on the appropriate capital structure for the company (whether to borrow money, to pay dividends, or to increase or reduce the number of shares on issue)
- deciding on the nature and form of the company's activities (what enterprise to carry on and how to use the company's capital).

The distinguishing feature of the management structure of many companies is that it involves the separation of responsibility for decisions made in constituting and running the company between members and officers.

Who are the company's officers, and what is their role?

As explained previously, members of the company are, in a general sense, its proprietors. The ***officers*** of the company are those persons responsible for its management. In small companies, the members and officers may be the same people (and indeed in single director/shareholder companies are always the same person). However, in large companies with many members it is not possible for all the members to take an active part in the management of the company. In these cases, the separation of the roles of officers and members in corporate decision-making is more pronounced.

Only a natural person (that is, a human being) can be appointed as an officer of a company.

The officers of the company include its ***directors***. All proprietary companies are required to have at least one director and all public companies at least three. Where a company has more than one director, the directors collectively are referred to as the ***board of directors***. The directors are selected in the manner agreed between the members and reflected in the company's internal governance rules[8] and are usually responsible for

8 See ¶1-500 for a definition of internal governance rules. Internal governance rules are discussed in Chapter 5.

managing the business of the company. The precise scope of the directors' powers, and the division of decision-making power between members and directors, depends on the law and the company's internal governance rules. The division of power between directors and members is discussed in Chapter 6.

Usually, the directors will be responsible for making most decisions affecting the company, without requiring the approval of members and without being required to comply with instructions from the members. However, certain fundamental decisions, such as changes to the company's internal governance rules and changes that affect the rights of members, will require the approval of members. The decisions requiring member approval are discussed in Chapter 7.

In small companies the directors themselves will generally make most of the ongoing decisions relating to the company. However, in large complex business enterprises the directors may delegate management functions to the company's executives, and retain responsibility for selecting and supervising those executives, and setting the broad strategic direction for the company.

Directors may be ***executive*** or ***non-executive*** directors. Executive directors are those who are employed by the company and devote all or substantially all of their working time to managing the company's affairs. Non-executive directors are not employed in the company's business and provide an 'outsider's' contribution and oversight to the board of directors.

All public companies must also have a ***secretary***. Most proprietary companies also have a secretary, although the appointment of a secretary for a proprietary company has been optional since March 2000. The secretary is responsible for certain administrative and reporting functions set out in the law. A person can be both a director and a secretary; a situation that is common in smaller companies.

In addition to its directors and secretary, a company may have other officers. Company law imposes certain duties and restrictions on directors and other company officers. Directors and other officers must act honestly, act in the interests of their company, and also act with care and diligence. These duties are discussed in Chapters 11–14.

The general responsibility for management of the company remains with the directors while the company is solvent and operating normally. However, in some circumstances the management of the company passes from the directors to an external administrator. This most often occurs when the company is insolvent or is being wound up. Where the company is being wound up, the person managing the company is called its liquidator. External administration is discussed in Chapter 25.

[¶1-260] What are a company's key legal attributes?

Company law clothes companies with special legal characteristics or attributes that enable them to undertake activities in their own right. The law makes companies into legal entities that are separate from their participants.

The law also confers on companies the legal capacity (that is, the capacity to do things that have legal effect) of a natural person. It gives it perpetual succession – that is,

the company continues to exist indefinitely until it is wound up. Winding up is discussed in Chapter 25.

Finally, the law confers limited liability on members of companies limited by shares. The important concepts of separate legal personality, corporate capacity and limited liability are explained in Chapter 3.

THE HISTORICAL DEVELOPMENT OF COMPANIES

[¶1-300] How did companies develop?

It is important, when studying company law, to understand the history of companies and the development of company law in the social and economic context in which they occurred. This helps to make clear why the rules evolved in the way they did and how they work in relation to modern companies.

Some key milestones in the historical development of the modern company were:

- the emergence of the ***corporation aggregate*** and the concept of ***joint stock*** during the 15th to 19th centuries
- the introduction of legislation to make incorporation available as a general right in 1844
- the introduction of limited liability under statute in 1856
- the recognition of the proprietary company as a distinct form of company in 1896
- confirmation that the privileges of incorporation extend to small, closely held companies, in *Salomon's* case in 1897
- the statutory facilitation of true 'one-person' companies in 1998.

These key milestones are described below.

[¶1-320] What are *corporations aggregate* and *joint stock*, and when did these concepts develop?

The development of the modern Australian commercial company can be traced back to the earliest ***corporations aggregate***, which emerged in England during the Middle Ages as a means of conferring on a group of people the capacity to hold and deal with property and interests to advance their collective aims. Bodies such as municipal boroughs, trade guilds and colleges facilitated joint activity through conferring legal existence on a group that was independent of the (perhaps fluctuating) identity of the members from time to time.

Frequently, as was the case with the trade guilds and merchants' associations, the corporation existed as the beneficiary of some special right or entitlement conferred by the Crown, such as a monopoly or the right to control the operation of a particular trade.

The creation of a corporation aggregate — its *incorporation* — required the consent of the Crown, through a Royal Charter.

During the 17th century, incorporation was granted by Royal Charter to various 'merchant venturers',[9] conferring upon them rights to conduct trade in a particular region.

9 JH Farrar and BM Hannigan, *Farrar's Company Law* (4th edn, 1998), p 17.

Well known examples of such corporations include the East India Company, the Hudson's Bay Company and the Massachusetts Bay Company, which had clear links to England's developing colonial activities. These corporations shared with the modern company the attributes of separate legal personality discussed below.

What is *joint stock*, and why is it important?

The 17th century also marked the development of what is known as ***joint stock***. The more ambitious commercial activities of the period required, in many cases, greater amounts of capital than a single individual could provide. To meet this need, commercial practice developed a mechanism whereby a person could invest a sum of money in a venture (or ongoing series of ventures), receiving in return an entitlement to share in the profits of the venture. The investors' entitlement was represented by a share. Such shares were transferable and could be sold by the investor without the consent of other investors.

In some cases (such as the East India Company) the venture was carried on by a corporation, and the share represented a claim against the corporation. However, as incorporation could be achieved only by Royal Charter and was relatively rare, many such ventures were carried on through a form of unincorporated association that became known as a 'joint stock company'.

What is the South Sea Bubble?

By the beginning of the 18th century, there was a well-developed secondary market for shares in these ventures, and speculation was rife. Shares in one company formed in 1711, the South Sea Company, rose in price from £100 to £1,000 in a matter of days. It has been estimated that the amounts invested in such ventures immediately before the collapse of the boom amounted to £500 million, twice the value of all the land in England at the time.[10] This period is referred to by legal historians as the 'South Sea Bubble'.

The bubble finally collapsed in 1720, resulting in large losses and considerable hardship for many members of England's growing middle class. In response, parliament passed legislation, called the Bubble Act, to prohibit such associations from acting as bodies corporate and from issuing transferable shares without the legal authority of a Royal Charter or an Act of Parliament.

Although the joint stock company became illegal in 1720, the commercial factors that gave rise to it did not go away, and indeed those factors continued to grow in importance throughout the 18th century. Incorporation by Royal Charter or Act of Parliament remained difficult to obtain. Large scale ventures, such as the development of railways, demanded a means of raising capital from investors to be utilised by managers in these projects. Lawyers developed the 'deed of settlement company' as a means of achieving these commercial aims while circumventing the prohibition contained in the Bubble Act.[11]

What were deed of settlement companies?

Deed of settlement companies were, essentially, a combination of association and trust. The assets of the venture were held on trust by trustees, and the venture managed by the

10 Ibid, 18.

11 Although it is not clear that deed of settlement companies were outside the Bubble Act: ibid, 19.

managers or directors. The venture did not have separate legal personality, and its property, rights and obligations were held by the trustees. Investors received a share that represented an interest in the trust property. Such shares were often expressed to be transferable under the terms of the trust, which were contained in the deed of settlement. Attempts were made in drafting the deed of settlement to limit the liability of the investors to the amount invested by them in the enterprise.

By the beginning of the 19th century, deed of settlement companies were becoming more common in England. However, they were complex to establish and administer, were ineffectively regulated by the state, and did not confer upon participants many of the benefits of separate legal personality that a corporation possessed. Following the repeal of the Bubble Act in 1825, various means of better facilitating and regulating these commercial arrangements were explored. New legislation for the registration and regulation of deed of settlement companies was enacted in England in 1844, following the report by a Parliamentary Select Committee chaired by William Gladstone. The 1844 Act is sometimes described as 'the legislative ancestor of modern company law'.[12]

[¶1-340] When did the right to incorporate companies become generally available?

The 1844 Act allowed business associations to become companies by a process of registration. Before that time, incorporation had been a privilege conferred by Royal Charter or by Act of Parliament. Now, any group wishing to form a company for a lawful purpose could apply for registration and, by lodging the required information and paying the prescribed fees, could obtain it. Registration was granted in two stages, provisional and final, with final registration being available only after the company had secured investments from a quarter of the proposed final number of investors.

The fact that companies registered under the 1844 Act were corporations, and therefore had the key attributes of separate legal personality, did not of itself confer limited liability on the participants in the company. If the debts of a company incorporated under the 1844 Act exceeded its assets, creditors of the company could pursue individual investors once their claims against the company had been exhausted. Attempts to limit investors' liability depended on specific agreement with creditors or on complex drafting in the deed of settlement itself. However, unlimited liability was seen as a disincentive to investment, requiring investors to monitor closely the financial position (and therefore ability to meet their share of any claim by a creditor) of other investors and the activities of managers.

[¶1-360] When was limited liability first introduced?

In 1855, the English Parliament passed the *Limited Liability Act 1855*, which allowed those forming a company to elect to do so on the basis that the liability of its investors would be limited to the amount they agreed to invest in the company. These companies were required to include the word 'limited' in their name, to alert those dealing with the company to the fact that the liability of the members was limited.

12 RP Austin and IM Ramsay, *Ford, Austin and Ramsay's Principles of Corporations Law* (17th edn, 2018), [2.130].

Various reform proposals over the next six years resulted ultimately in the enactment of the *Companies Act 1862* (UK) (the 1862 Act), consolidating the procedures for incorporation and winding up of companies and putting in place many of the key features of modern company law. The 1862 Act was adopted by the Australian states as the model for their own companies legislation and the position in England was therefore mirrored in Australia. Companies formed under the 1862 Act, on which Australian company law is substantially based, had many of the attributes of the modern commercial company.

[¶1-380] When were companies first used for small business?

The Chapter so far has discussed the historical development of the company as a means of bringing together providers of capital (investors) with specialist business managers or entrepreneurs in larger scale, collective enterprises. Typically this involved asking members of the public for investment and required a separation of ownership of the enterprise (which was in the hands of a large, fluctuating membership) and its management. Company law developed in part for the protection of public investors and adopted the large-scale collective enterprise as its model.

However, the attributes of companies, in particular the limited liability conferred on their members, also made them an attractive form through which to carry on small business. Typically a company formed to carry on a small business would not have public investors, and would be controlled and managed by its main investor, often a person who had perhaps conducted the business as a sole trader before its incorporation.

The fact that the 'corporation aggregate' model was adopted for company law was reflected in the fact that the companies legislation required that companies have a certain minimum number of members. Historically, incorporation required the coming together or association of more than one person to form a company. This position has now been reversed by statute (see below).

What was the significance of *Salomon's* case?

It was not clear until the landmark English case of *Salomon v Salomon & Co Ltd* in 1897 that the benefits of incorporation would extend to incorporated small businesses that were effectively under the control of a single entrepreneur. *Salomon's* case is discussed in detail below. A business formed and operated by Mr Salomon as a sole trader had been transferred by him to a company which he had formed under the 1862 Act and in which he was the major shareholder and controller. To meet the then statutory requirement that a company have at least seven shareholders, shares were issued to other members of his family, but those family members did not have any real interest in the business.

Mr Salomon transferred his business to the company in order, among other things, to obtain limited liability. He intended that, if the business failed, his personal wealth would not be put at risk as he would not be personally liable to satisfy the outstanding claims of the business's creditors.

The English Court of Appeal initially took the view that such an arrangement should not attract all the benefits of incorporation (including limited liability for Mr Salomon and the other family members). One judge said:

> It would be lamentable if a scheme like this could not be defeated. If we were to permit it to succeed, we should be authorising a perversion of the Joint Stock Companies Acts … The transaction is a device to apply the machinery of the [Act] to a state of things never contemplated by that Act — an ingenious device to obtain the protection of that Act in a way and for objects not authorised by that Act, and in my judgment in a way inconsistent with and opposed to its policy and provisions.[13]

Another judge took the view that:

> If the legislature thinks it right to extend the principle of limited liability to sole traders it will no doubt do so, with such safeguards, if any, as it may think necessary. But until the law is changed such attempts as these ought to be defeated wherever they are brought to light. They do infinite mischief; they bring into disrepute one of the most useful statutes of modern times, by perverting its legitimate use, and by making it an instrument for cheating honest creditors.[14]

Therefore, the Court of Appeal held that Mr Salomon and his company should not be accorded the privileges of incorporation. Mr Salomon appealed and the court's decision was reversed by the English House of Lords. The House of Lords said, in relation to small business:

> It has become the fashion to call companies of this class 'one man companies'. That is a taking nickname, but it does not help one much in the way of argument. If it is intended to convey the meaning that a company which is under the absolute control of one person is not a company legally incorporated, although the requirements of the Act of 1862 may have been complied with, it is inaccurate and misleading: if it merely means that there is a predominant partner possessing an overwhelming influence and entitled practically to the whole of the profits, there is nothing in that that I can see contrary to the true intention of the Act of 1862, or against public policy, or detrimental to the interests of the creditors.[15]

The final decision was that the benefits of incorporation were capable of extending to small, private companies, even though such companies arguably were not the type of business which the companies legislation was intended to facilitate. The decision in *Salomon's* case confirmed the availability of the limited company as a vehicle for both large and small business, whether or not it involved public investors.

When was the concept of a proprietary company introduced?

Around the same time that the decision in *Salomon's* case confirmed that the benefits of incorporation were available to small, privately owned businesses, the Victorian Parliament passed the first legislation in the common law world providing for different, less onerous regulation of these types of companies. New disclosure requirements designed to protect public investors, introduced into Victorian law in 1896, were expressed not to apply to **proprietary companies**. Proprietary companies are companies that have a limited number

13 [1895] 2 Ch 232 at 340–341, per Lopes LJ.

14 Ibid, per Lindley LJ.

15 [1897] AC 22 at 53.

of members and that are not permitted to ask the public for investment (except by way of crowd funding platforms, and then subject to certain requirements). The proprietary company is by far the most common type of company in Australia.

When did it become possible to have a one-person company?

In 1998, the then Corporations Law (now the Corporations Act) was amended to enable the use of companies for small, one-person businesses. Since 1 July 1998 it has been possible to form a company that has only one participant. These are referred to in this book as **single director/shareholder companies**. These companies are discussed further in Chapter 5. The introduction of the single director/single shareholder company represents the final departure from the concept, reflected in the views of the Court of Appeal in *Salomon's* case, that association of at least two members is necessary to create a company.

CORPORATE PURPOSE

[¶1-400] What is the purpose of companies?

For almost a century, people have argued about what the 'purpose' of companies is or should be. This debate usually focuses on role of the business corporation in society, rather than on the purpose of the company as a legal form.[16]

The debate was initially framed in the Harvard Law Review between Professors Adolf Berle and E Merrick Dodd in 1931–1932.[17] A key question is whether the business corporation exists just to generate returns for shareholders, or whether it has a broader purpose. In 2001, a review of company law for the United Kingdom examined "the question of scope – i.e. in whose interests should companies be run".[18] The different points of view are sometimes referred to as "the shareholder value principle (or paradigm), also known as the shareholder primacy principle or the shareholder wealth maximisation norm, and the stakeholder theory".[19]

Company law does not specify the purpose of companies and the corporate form is flexible enough to be used in for-profit and not-for-profit activities. However, over the last decade, community calls for business corporations to frame their purpose in terms that are broader than shareholder wealth maximisation have increased. This has led to a change in the attitude of many self-regulatory organisations to this issue.

In Australia in February 2019, the ASX Corporate Governance Council inserted new recommendations into the fourth edition of its *Corporate Governance Principles and*

16 See Pamela Hanrahan, 'Companies, corporate offices and public interests: Are we at a legal tipping point?' (2019) 36 Company and Securities Law Journal 665.

17 See Adolf A Berle, "Corporate Powers as Powers in Trust" (1931) 44 Harvard Law Review 1049; E Merrick Dodd, "For Whom Are Corporate Managers Trustees?" (1932) 45 Harvard Law Review 1145; Adolf A Berle, "For Whom Managers Are Trustees: A Note" (1932) 45 Harvard Law Review 1365.

18 Company Law Review Steering Group (UK), Modern Company Law for a Competitive Economy Final Report (2001) Vol 1, 41.

19 Andrew Keay, "Tackling the Issue of the Corporate Objective: An Analysis of the United Kingdom's 'Enlightened Shareholder Value Approach'" (2007) 29 Sydney Law Review 577.

Recommendations that reflect this trend. It now recommends that "a listed entity should articulate and disclose its values". The commentary to the new recommendation says:

> A listed entity's values are the guiding principles and norms that define what type of organisation it aspires to be and what it requires from its directors, senior executives and employees to achieve that aspiration. Values create a link between the entity's purpose (why it exists) and its strategic goals (what it hopes to do) by expressing the standards and behaviours it expects from its directors, senior executives and employees to fulfil its purpose and meet its goals (how it will do it).[20]

In the United States in August 2019, the Business Roundtable released a revised statement on the purpose of a corporation that moved away from shareholder primacy to recognise the interests of other stakeholders:

> While each of our individual companies serves its own corporate purpose, we share a fundamental commitment to all of our stakeholders. We commit to:
>
> Delivering value to our customers. We will further the tradition of American companies leading the way in meeting or exceeding customer expectations.
>
> Investing in our employees. This starts with compensating them fairly and providing important benefits. It also includes supporting them through training and education that help develop new skills for a rapidly changing world. We foster diversity and inclusion, dignity and respect.
>
> Dealing fairly and ethically with our suppliers. We are dedicated to serving as good partners to the other companies, large and small, that help us meet our missions.
>
> Supporting the communities in which we work. We respect the people in our communities and protect the environment by embracing sustainable practices across our businesses.
>
> Generating long-term value for shareholders, who provide the capital that allows companies to invest, grow and innovate. We are committed to transparency and effective engagement with shareholders.

SOME KEY TERMS

[¶1-500] What do these terms mean?

Set out below is a summary of some of the terms and concepts introduced in this Chapter.

Company is a particular type of corporation that is formed by being registered under the Corporations Act. The company is the most common form of corporation used in Australian business.

Company limited by shares is a particular type of company. In a company limited by shares, members have purchased shares by making a contribution to the company. If the company becomes insolvent, the members generally are not required to make any further contribution to meet the company's debts.

20 ASX Corporate Governance Council Corporate Governance Principles and Recommendations (4th ed, 2019) 16.

Corporation or ***body corporate*** is the general term used to describe an artificial person created by law to hold property and legal rights and incur obligations. A corporation is treated as a separate person from those who own shares in it or participate in its operation. This means the identity of the corporation is not affected by changes in the identity of those persons.

Corporations Act (the *Corporations Act 2001* (Cth)) is the statute governing the creation, operation and termination of companies in Australia.

Director is a person appointed in accordance with the company's internal governance rules to manage the business of the company. In small companies, the members may all be directors of the company, but in large public companies, with thousands of members, this will not be the case.

External administration refers to the situation where management of the company or its assets has passed from the company's board of directors to an external person such as an administrator, receiver or liquidator. Generally this occurs as a result of the company being insolvent or being wound up.

Insolvency means that the company is unable to pay all its debts as and when they become due for payment.

Internal governance rules are the rules agreed by the members of the company that govern matters connected with its internal administration, such as arrangements for appointing and removing directors, arrangements governing directors' meetings and members' meetings, details of the rights attaching to shares and procedures for the transfer of shares. A company may use the ***replaceable rules*** (which are a set of rules contained in the Corporations Act) as its internal governance rules, or replace some or all of those rules with a ***constitution*** approved by the members.

Limited liability is a term used to describe the fact that shareholders in a company limited by shares are not liable to contribute additional money to meet the company's debts, beyond the amount initially agreed to be paid for the share.

Listed company is a company that has its shares listed for quotation on the Australian Securities Exchange (ASX). This means that members of the public can buy and sell shares in the company through the stock market operated by the ASX. All listed companies are public companies.

Proprietary company is one type of company — public companies are the other. Proprietary companies are usually not permitted to have more than 50 members or to raise money by conducting a public offer of shares (the exception is under the crowd-sourced equity funding rules). In return for accepting these restrictions, proprietary companies are exempted from many company law rules that are designed to protect investors who do not participate actively in the operation of the business. Most Australian companies are small businesses and most of these are proprietary companies.

Public company is any company that is not a proprietary company. Public companies have wider powers to raise capital from members of the public than proprietary companies, but are subject to more onerous regulation.

Secretary is a person responsible for performing certain administrative functions required by law in connection with the company. The secretary is appointed by the directors.

Share is a claim against the company issued by the company to a person who contributes equity capital to the company. It is a form of personal property that represents an asset in the hands of the person who owns it. A person who owns a share in a company is called a ***shareholder*** or a ***member***. The members are the ultimate owners of the company. Shares have rights attaching to them that may give the holder the right to share in the company's profits and to have some say in certain fundamental decisions affecting the company.

Winding up refers to the process by which a liquidator realises and distributes all of a company's property in order for the company's existence to be terminated.

CHAPTER 2

Company Law

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[¶2-001] Introduction

This Chapter is an introduction to company law. It begins by looking at the scope of company law, and summarising the issues addressed by company law and the nature of the obligations and duties created by it.

The second part then goes on to identify the main sources of the legal rules governing companies and their participants. It includes a detailed treatment of the history, structure and effect of the *Corporations Act 2001* (Cth) (Corporations Act), which is the main statute governing companies in Australia.

The third part gives some guidance about how to apply the legal rules to a particular fact situation. It includes some guidance for students of company law about how to approach problems and questions in class situations and assessment tasks.

The fourth part looks at the way companies are regulated. In particular, it looks at the role of the Australian Securities and Investments Commission (ASIC), the Australian Securities Exchange (ASX) and the courts in regulating companies.

SCOPE AND OPERATION OF COMPANY LAW

[¶2-100] What is 'company law'?

Company law:

- provides for the formation (and, ultimately, termination) of companies
- confers on companies some special attributes (for example, separate legal personality)
- sets out the rules governing the duties of, and relationships between, participants in companies (for example, the relationship between directors and shareholders)
- facilitates dealings between companies and outsiders (an example of an outsider is a customer of the company).

These functions of company law are discussed in this Chapter.

As legal entities, companies are subject to the law in the same way as all other legal persons. This means that laws such as criminal law, property law, contract law, tort law, trade practices law and environmental law apply to companies (sometimes with some necessary modifications to take account of the fact that companies are artificial persons). The fact that these laws apply to companies does not make them part of what we generally consider to be ***company law***.

[¶2-120] What does company law cover?

The aspects of company law that are dealt with in this book can, for the most part, be fitted into one of the following four broad categories. Company law deals with:

- the creation and termination of companies, and confers on companies and their participants particular legal characteristics (separate legal personality, legal capacity and limited liability).
- the relationships (i) between participants in companies (members, directors and other officers of the company, and sometimes employees), and (ii) between the company and its participants (in particular, rules relating to members' rights, directors' duties and other matters relating to the management of companies). However, company law is not the only law that deals with the relationships between participants in companies. For example, the relationship between employees and their company is regulated by industrial relations law. (Industrial relations law deals with the working conditions of employees, including the hours to be worked and the wages to be received.)
- corporate finance. The law sets out special rules that enable companies to raise capital, including equity capital (raised through the issue of shares by the company) and debt finance.
- the implications for those outside companies of dealing with a company rather than an individual. A person may deal with a company voluntarily, for example, by entering into a contract with the company. A person may also deal with a company involuntarily, for example, where the person is the victim of a crime or an act of negligence committed by an officer of the company. There are rules that help determine when the actions of the officer will be treated as the actions of the company so that the company is liable to the person affected by the crime or act of negligence.

These four broad themes are reflected in the structure of this book.

How does company law provide for the formation and termination of companies, and confer their characteristics?

Through the first set of rules, company law provides for the formation and termination of companies. As companies are artificial legal persons created and extinguished by the state, laws are necessary to confer or withdraw their existence. The special characteristics of companies — separate legal personality, corporate capacity and the limited liability of members — exist because they are provided for by company law. Company law both confers, and defines the limits of, these characteristics.

How does company law govern the internal management of companies?

The second set of rules governs how the members of the company relate to each other and to the directors and other officers. The members are the people who own shares in the company (in the case of a company with share capital). These rules determine the rights and duties of each type of participant.

Company law establishes the rules for managing companies, providing for the appointment of officers to run the company, prescribing the respective decision-making powers of members and directors, and imposing duties on officers in the performance of their functions and limitations on members' exercise of their voting powers in certain circumstances.

In addition, it governs the mechanics of running a company (including the procedures for calling and conducting meetings of directors and of members), particularly through

providing the framework for the operation of the company's internal governance rules. It also provides for sanctions and remedies where these rules are contravened.

How does company law apply to corporate finance?

Companies are differently positioned from other entities in the way they raise capital. A company can raise equity capital through the issue of shares, which may be ordinary shares or shares in a class with different or special rights attached. Shares may be issued fully or partly paid. Company law rules allow for the issue of shares and provide for the maintenance of the company's issued capital during its life.

Company law also includes special rules that apply to companies as borrowers. In particular, it provides for the issue of debentures by companies. Company law and the related area of corporate insolvency law affect the relationship between companies and their creditors.

How does company law affect dealings between companies and outsiders?

The fact that companies exist as separate legal persons raises particular issues for those who deal with them. These are addressed by the third set of rules. These rules operate as an interface between the company and the operation of the general law.

A person may come to deal with a company voluntarily, where the person elects to enter into a legal relationship with that company (say through entering into a contract with the company). A person may involuntarily come to deal with the company where the company commits a wrong that affects the person and the wrong is capable of legal remedy. For example, a person who lives next door to a company's premises may be affected by a breach by the company of laws preventing pollution.

Because companies, as artificial persons, can only act through individuals, the issue for the person having dealings with the company is: when is that individual's actions treated as actions of the company, so the company is liable for those actions? This is sometimes referred to as the question of attribution. This is the central concern of the fourth group of rules.

[¶2-140] How is company law enforced?

Company law operates in some cases to impose duties or obligations on people and companies. If a person or company breaches one of these rules of company law then, depending upon which rule is breached, one or both of the following may result:

- The person may be ordered to change their behaviour, or may be subject to a public law sanction, such as a fine or a term of imprisonment (companies may also have to pay fines if they breach some rules). A public law sanction is imposed by the state.
- The person or company may be stopped from engaging in the wrongful conduct or required to do some further act or thing, or required to compensate any person harmed by the breach, for example, by paying damages. This is a private law remedy — that is, company law confers private rights on individuals that can be enforced through the courts.

How can company law impose both public and private sanctions?

In some cases, where a person contravenes a part of company law, they can be punished by the state (in the form of fines or imprisonment). This is because contravention of certain provisions of the Corporations Act is a criminal offence.

Other provisions of the Corporations Act are ***civil penalty provisions***. Where a person contravenes a civil penalty provision, they may be subject to criminal prosecution (if they did so with dishonest intent) or to a civil penalty order (in other cases), which is also a form of public law or state sanction.

Breaches of certain provisions of the Corporations Act may also result in a person being banned from participating in the management of companies for a specified period. These banning orders operate both to protect the public from being exposed to dealing with people who have a history of unlawful conduct in managing companies, and as a form of state sanction.

In many cases where a criminal or civil penalty sanction attaches to a contravention, and in others where it does not, breach of a rule of company law may give rise to a right, in the person harmed by the breach, to compensation.

Alternatively or in addition to a right to some form of compensation, a person affected by an act or omission of a person that breaches company law rules may be entitled to ask the court for orders requiring or prohibiting particular conduct. These are examples of private law rights or remedies, in that a person affected does not have to rely on the state to enforce the obligation on their behalf.

Sanctions are discussed in more detail in Chapter 15.

An example of the application of public and private sanctions

The following is an example of the application of public and private law sanctions to a person who contravenes a requirement of company law.

Example

Assume a director of a company breaches the rule of company law prohibiting her from making improper use of her position to gain an advantage for herself.[1] If she does so dishonestly, the director commits a criminal offence and can be fined or imprisoned or both.[2] If she does so unintentionally, for example without considering whether what she did was in the best interests of the company, then she can be made the subject of a civil penalty order and required to pay a pecuniary penalty to the government. This is another form of public law sanction.[3] Finally, if the company has been harmed by her actions, it can seek damages or an account of profits from the director, to compensate it for the harm it has suffered or the benefit of which it

1 This is prohibited by s 182 and is a breach of the director's fiduciary obligations to the company.

2 This contravenes s 184 and is an offence. The consequences of committing an offence under the Corporations Act are set out in Pt 9.4 of the Corporations Act.

3 The civil penalty provisions are contained in Pt 9.4B of the Corporations Act.

has been deprived.[4] It can also seek orders that the director stop doing the harmful thing. These are private law remedies.

So, company law can work as both a source of private law rights (that is, confer rights on private citizens that can be enforced by them in the manner of, say, a contract) and public law duties (that is, impose requirements on people that can be enforced by the state).

[¶2-160] What are the main sources of company law?

Company law is derived from a number of different sources. This means that it may be necessary to look in more than one place to see if a particular action or proposal is affected by legal rules. Important sources of company law include:

- the Corporations Act
- case law
- other sources of law, including the Corporations Regulations; the *Australian Securities and Investments Commission Act 2001* (the ASIC Act); ASIC exemptions, modifications and guidelines; the Australian Accounting Standards Board's Accounting Standards and the ASX Listing Rules.

These sources of law are discussed in ¶2-200–¶2-360.

THE CORPORATIONS ACT

[¶2-200] What is the Corporations Act?

The main statute regulating companies in Australia is the Corporations Act. The Corporations Act contains many of the key legal rules that govern or facilitate the formation, management, operation and termination of companies.

The Corporations Act also regulates takeovers, provides for the registration and operation of managed investment schemes, and sets out the licensing and disclosure rules that apply to financial products, financial services and financial markets. These matters are related to, but not considered part of, the 'core' of company law. An introduction to these related matters is contained in Chapters 21 and 22.

The Corporations Act commenced on 15 July 2001, replacing the former Corporations Law (see ¶2-220).

[¶2-220] What is the background to the Corporations Act?

Chapter 1 looked at the historical development of companies. Here, we look at the history of company law statutes in Australia. The Corporations Act is the most recent in a series of statutes governing companies which have moved over time towards a national approach to company law.

4 Under an action for breach of fiduciary duty or pursuant to Pt 9.4B. See Chapter 15 for more detailed discussion.

Some key milestones in the evolution of Australian companies legislation are:

- the introduction of separate company law legislation in each state, based on the English Companies Act of 1862
- the development of the Uniform Companies Acts of 1961
- the introduction of the cooperative scheme legislation in 1981
- the commencement of the Corporations Law in 1991
- the commencement of the Corporations Act in 2001.

These important stages in the development of company law are outlined below.

The early state laws governing companies

Until 2001, the power to make laws relating to companies belonged to the government of each Australian state and, in the case of the territories, to the Commonwealth Parliament.

As noted in Chapter 1, the historical precursor to the Corporations Act was the English Companies Act of 1862. By the end of the 19th century, each of the Australian states had enacted companies legislation based in part on the 1862 Act, although the precise terms of the statutes differed in each case and some contained unique features, such as the special provisions relating to proprietary companies introduced into the Victorian legislation in 1896.

Throughout the first half of the 20th century, each state developed and amended its own legislation, so that by the end of the 1950s the regulation of companies in the different states was not uniform.

The Uniform Companies Acts of 1961

As companies expanded their operations beyond state and territory boundaries, it was felt that this lack of uniform regulation resulted in inconvenience and cost to business. Attempts were made to overcome these problems through uniform national legislation.[5]

In the early 1960s, the governments of the various states each agreed with the Commonwealth to enact uniform companies legislation. This was done progressively during 1961–1963, with the new legislation coming into force on 1 July 1962 in Victoria, New South Wales, Queensland and the Australian Capital Territory, on 5 October 1962 in Western Australia, on 1 January 1963 in Tasmania, on 1 July 1963 in South Australia and the Northern Territory, and on 1 July 1964 in the Territory of Papua and New Guinea, which was not yet independent of Australia.

Interestingly, this uniform legislation went on to provide the model for the *Companies Act 1965* of Malaysia and the *Companies Act 1967* of Singapore.

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5 The following discussion shows that, in Australia, uniform national regulation of companies has been seen as an important goal since the 1950s, and the history of company law since that time shows increasing moves towards national legislation. It is therefore interesting to note that, in the United States of America, national company law is not considered important. Each of the 50 American states has its own distinct company law, although American securities laws (governing the issue of securities to the public and secondary trading in securities, and imposing certain investor protection requirements on companies that have issued securities to the public) are federal laws.

This legislation operated throughout the 1960s and 1970s. The administrative functions connected with company law were carried out by state and territory Registrars of Companies, which were part of the state and territory (rather than national) bureaucracy.

During the late 1960s and the 1970s, company law, and in particular securities law, continued to expand and develop. Important reforms adopted by the Commonwealth and most of the states in 1971–1972 aimed to increase the protection afforded to public investors in companies through rules governing accounts and audit, takeovers, and trading in securities on the basis of non-public information.[6]

The sustained boom in mining shares during the late 1960s and its effect on the operation of Australian stock markets revealed improper trading practices that led to substantial amendment to the laws governing trading in securities, including the enactment of Securities Industry Acts in a number of states. The regulatory authorities expanded their role, from merely operating a registry of companies to taking an active role in policing conduct. In many states, this expanded role was accompanied by a change of name, from Registrar of Companies to Corporate Affairs Commission.

Despite its title, the uniform companies legislation of the 1960s was not uniform. Further, companies having dealings in more than one state or territory were required to deal separately with the different regulatory authorities in each place. In many cases the procedures and policies of each regulator were different. This was overcome to some degree by the establishment of the Interstate Corporate Affairs Commission in 1974, which provided for a cooperative approach to regulation between the Commonwealth, New South Wales, Victoria, Queensland and (from 1975) Western Australia. However, other attempts by the Labor Government during 1972–1975 to introduce national regulation of companies did not come to fruition.[7]

The cooperative scheme 1981–1991

Following the change of federal government in 1975, attempts to move towards more uniform national regulation continued. However, where it had been the Labor Party's aim to transfer responsibility for company law to the Commonwealth Parliament, the Coalition Government favoured an approach under which the states retained responsibility for company law but enacted and administered it on a more cooperative, coordinated basis. In 1978 a formal agreement was reached between the Commonwealth and the governments of each of the states which provided that:

- the Commonwealth would enact legislation to serve as the model for uniform company laws to be enacted by each of the states
- a national regulatory body, the National Companies and Securities Commission (NCSC), would be established. The state corporate affairs commissions would operate

6 These amendments followed from the report of the sub-committee of the Company Law Advisory Committee, chaired by Richard Eggleston. The Eggleston Committee was established in 1967 after the collapse of a number of high-profile finance companies that had borrowed heavily from the public through the issue of debentures (which are a type of security).

7 These included the proposed Corporations and Securities Industry Bill and National Companies Bill.

as delegates of the NCSC and remain responsible for much of the routine work of company registration.

The agreement provided for the NCSC to be accountable to the Ministerial Council, which was to be made up of representatives of the Commonwealth and the states. The Ministerial Council would also be responsible for law reform and questions to do with the administration of the legislation.

This arrangement was known as the ***cooperative scheme***. A package of uniform legislation which included the *Companies Act 1981* (Cth) and corresponding Codes commenced in all states and territories except the Northern Territory on 1 July 1981, and in the Northern Territory on 1 July 1986.

When the Labor Government was returned in 1986, it resumed its push for Commonwealth regulation of companies. The cooperative scheme, although reasonably successful, had its critics. Obtaining agreement of the Ministerial Council to amendments to the law made law reform difficult. Some people felt that there were problems of ministerial accountability in the structure because of the number of Commonwealth and state ministers involved in the cooperative scheme. The NCSC was under-resourced and it was believed that the distribution of functions between the NCSC and the state corporate affairs commissions led to duplication of functions and inefficiency.

In 1989 the Commonwealth Parliament passed the *Corporations Act 1989*, by which it attempted to exercise power to legislate on a national basis with respect to companies. The 1989 legislation was challenged by the states in the High Court on the basis that the Commonwealth did not have power under the Commonwealth Constitution to pass it. That challenge was successful.

The Corporations Law 1991

Following the successful High Court challenge to the 1989 Commonwealth Act, the Commonwealth negotiated with the states to achieve a cooperative system of regulation of companies that gave the Commonwealth increased powers over amendments to the law and responsibility for a unitary regulatory structure. Agreement was reached between the Commonwealth and state ministers at Alice Springs on 29 June 1990. Under that agreement, the following arrangements were put in place:

- Each state agreed to enact legislation adopting an amended *Corporations Act 1989* as its state corporations legislation. The adopted legislation was called, in all states and territories, the Corporations Law.
- Responsibility for regulation of companies and securities was transferred to the Australian Securities Commission (now called the Australian Securities and Investments Commission (ASIC)), which is part of the Commonwealth bureaucracy.
- Provisions were included in the legislation to make the Corporations Law operate as if it were a Commonwealth statute of national application. These included provisions applying Commonwealth law relating to criminal procedure and administrative review. Provisions corresponding to the Commonwealth Acts Interpretation legislation were included in the Corporations Law to ensure that it was interpreted in accordance with the principles that govern the interpretation of Commonwealth law.

- Arrangements for amending the law were altered to give the Commonwealth Minister greater control. The Alice Springs agreement provided for the Commonwealth Minister to have the power to propose amendments, and gave that minister four votes and a casting vote on the Ministerial Council to approve those amendments. Each state minister had only one vote. Amendments to the Corporations Law affecting national markets (that is, takeovers, fundraising by companies, and the regulation of the securities and futures markets) did not require the approval of the Ministerial Council.

After its commencement in 1991, the Corporations Law was substantially amended on a number of occasions. Major amending Acts include the *Corporate Law Reform Act 1992* (Cth), the *Corporate Law Reform Act 1994* (Cth), the *First Corporate Law Simplification Act 1995* (Cth), the *Company Law Review Act 1998* (Cth) and the *Corporate Law Economic Reform Program Act 1999* (Cth).

The *Corporations Act 2001*

The constitutional validity of the cooperative arrangements underpinning the Corporations Law was cast into doubt in 1999/2000 by a series of decisions of the High Court of Australia that included *Re Wakim*[8] and *R v Hughes*.[9]

In *Re Wakim*, the High Court held that the cross-vesting arrangements in the Corporations Law (which allowed the Federal Court and the state Supreme Courts to hear corporations matters) were incapable of conferring jurisdiction on the Federal Court.

This had the effect of defeating the cross-vesting arrangements set out in the Corporations Law.

In *Hughes*, a person charged with an offence under the Corporations Law as it applied in Western Australia (that is, under the conferring *Corporations (Western Australia) Act 1990* (WA)) argued that the Commonwealth Director of Public Prosecutions (the DPP) did not have the power to prosecute him under what was, essentially, state law.

The High Court held that the DPP was competent to prosecute Hughes under the Corporations Law because of specific Commonwealth heads of power in the Australian Constitution. Significantly, Hughes's charges (which related to an investment scheme involving the United States) were supported by the Commonwealth's power to regulate trade and commerce with other countries and extraterritorial matters. The decision left open the possibility that, without the link to a direct Commonwealth head of power, a conferral of authority to the Commonwealth DPP (or other authority such as ASIC) may prove to be invalid. It may not be possible to establish such a link in the absence of special facts (such as the overseas transactions present in the *Hughes* case).

The court noted that a Commonwealth head of power supporting a provision in the Law 'will be true of perhaps the very great majority of offences created by the state legislation which adopts the Law'. But offences such as those relating to trusts and the formation of companies (unsupported by a Commonwealth head of power) may become

8 (1999) 17 ACLC 1,055; 163 ALR 270.

9 (2000) 18 ACLC 394; 171 ALR 155.

unenforceable at a federal level. In fact, past action by ASIC, such as company registration and granting exemptions or modifications, could be invalid, which in turn could have implications for the validity of convictions or civil penalties.

To resolve the uncertainty over the constitutional validity of the Corporations Law, the state Attorneys-General agreed in August 2000 to refer to the Commonwealth the power to make laws with respect to the matters contained in the then Corporations Law and Financial Services Reform Bill. The Commonwealth Parliament has power under s 51(xxxvii) of the Constitution to make laws with respect to 'matters referred to the Parliament of the Commonwealth by the Parliament or Parliaments of any State or States, but so that the law shall extend only to States by whose Parliament the matter is referred, or which afterwards adopt the law'.

Under the agreement reached between the joint Standing Committee of Attorneys-General and the Ministerial Council for Corporations, the substance of the Corporations Law scheme and the powers of Commonwealth authorities to carry out the scheme were referred to the Commonwealth. This provided a constitutional basis for the Commonwealth Parliament to enact the *Corporations Act 2001* as a Commonwealth law applying of its own force throughout Australia.

The new Corporations Act came into effect on 15 July 2001, replacing the Corporations Law. As a result, for the first time in its history, Australia now had a single national law governing the formation, operation and external administration of companies.

In general, the substantive provisions of the Corporations Act on its enactment were identical to the former Corporations Law. However, provisions of the Corporations Law that were included to ensure that it operated as a single law across Australia were removed, as they were no longer required. Some further changes were made resulting from the fact that the Corporations Act is a Commonwealth Act, while the Corporations Law was state law.

It is important to understand that the Commonwealth Parliament's power to make laws with respect to companies rests for the most part (although not entirely) on the referral of power made by the states for the purposes of s 51(xxxvii) of the Commonwealth Constitution. The referral is limited both in its scope and its duration. The referral allows the Commonwealth to enact laws in substantially the form of the then Corporations Law and the *Australian Securities and Investments Commission Act 2001* (the ASIC Act — see below), and to amend those laws in relation to 'the formation of corporations, corporate regulation and the regulation of financial products and services'.[10] However, the referral contains provisions that mean that the Commonwealth Parliament cannot use the powers referred to it to make laws with respect to industrial relations. Also, the referral is for a defined period, having been put in place initially for five years. It has been extended from time to time, most recently in 2016.

The referral of power that underpins the Corporations Act operates on the framework of an inter-governmental agreement made in December 2001. That agreement was

10 See s 4(1) of the *Corporations (Commonwealth Powers) Act 2001* of each state. The Corporations (Commonwealth Powers) Act is the legislation under which the referral is made.

formalised as the Corporations Agreement 2002. Under the inter-governmental agreement, ASIC remained, as it had been under the Corporations Law regime, solely responsible for the general administration of company law (see below). The agreement also provided for the continued involvement of a Ministerial Council, made up of representatives of the state and territory governments and the Commonwealth Government. The Ministerial Council has the right to be consulted on amendments to the Corporations Act. Generally, amendments to the Corporations Act cannot be made without the approval of at least three state or territory ministers.[11]

As Commonwealth law, the Corporations Act operates against the background of other Commonwealth legislation on criminal law, administrative law and statutory interpretation which applies to Commonwealth legislation generally. (This is sometimes referred to as 'adjectival law'.) For example, the Corporations Act is interpreted in accordance with the Commonwealth *Acts Interpretation Act 1901*. Similarly, the Commonwealth *Crimes Act 1914* and the *Criminal Code Act 1995* apply in relation to offences against the Corporations Act. The administration of the Corporations Act is subject to Commonwealth administrative laws including the *Administrative Decisions (Judicial Review) Act 1977*, the *Freedom of Information Act 1982* and the *Privacy Act 1988*.

The Corporations Act was substantially amended in 2001 by the *Financial Services Reform Act 2001* and related legislation (FSRA) and in 2004 by the *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004* (CLERP 9).

The Corporations Act and the Corporations Regulations are amended quite frequently. For example, in 2019, the Corporations Act was amended several times, including by the *Treasury Laws Amendment (Ending Grandfathered Conflicted Remuneration) Act 2019; Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Act 2019; Treasury Laws Amendment (2019 Measures No. 1) Act 2019; Corporations Amendment (Strengthening Protections for Employee Entitlements) Act 2019; Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 1) Act 2019; Treasury Laws Amendment (Mutual Reforms) Act 2019; Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Act 2019; and Treasury Laws Amendment (Enhancing Whistleblower Protections) Act 2019*. The titles of these amending Acts refer to the substantial reforms they contain. Many of these amendments covered matters considered by the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry that reported to government in February 2019. Keeping up with developments in the law is a significant challenge for company officers and their advisers.

[¶2-240] What does the Corporations Act contain?

The Corporations Act provides for the formation of Australian companies and the registration of foreign companies operating in Australia. It also regulates fundraising by

11 The Ministerial Council's approval is not required for amendments to specified provisions of the Corporations Act dealing with financial products and services, including managed investment schemes, takeovers, fundraising, and the regulation of the securities and futures industries. However, the agreement does allow the Ministerial Council to veto changes in these areas in some cases.

companies, company management, reorganisations, takeovers, and the liquidation and winding up of companies. The Corporations Act is also the statute that regulates the operation of financial markets, the provision of financial services and the offer of financial products in Australia.

The Corporations Act is an extremely long and complicated statute, with several thousand separate sections.

Does the Corporations Act apply to all kinds of companies?

The Corporations Act contains rules relating to all kinds of companies, so that the rules governing large public companies like Commonwealth Bank of Australia Limited are contained in the same statute as the rules governing small proprietary companies. Further, rules regulating financial markets and the conduct of financial services providers such as brokers, dealers and advisers are also included in the Corporations Act. Rules about the sale of financial products as diverse as home insurance, bank accounts, superannuation products, and securities and futures are also included.

How is the Corporations Act divided up?

The Corporations Act is divided into 29 separate Chapters. They are set out in this table:

Table 2.1 Chapters of the Corporations Act

Chapter 1	Introductory
Chapter 2A	Registering a company
Chapter 2B	Basic features of a company
Chapter 2C	Registers
Chapter 2D	Officers and employees
Chapter 2E	Related party transactions
Chapter 2F	Members' rights and remedies
Chapter 2G	Meetings
Chapter 2H	Shares
Chapter 2J	Transactions affecting share capital
Chapter 2L	Debentures
Chapter 2M	Financial reports and audit
Chapter 2N	Updating ASIC information about companies and registered schemes
Chapter 2P	Lodgments with ASIC
Chapter 5	External administration
Chapter 5A	Deregistration and transfers of registration of companies
Chapter 5B	Bodies corporate registered as companies, and registrable bodies
Chapter 5C	Managed investment schemes
Chapter 5D	Licensed trustee companies
Chapter 6	Takeovers
Chapter 6A	Compulsory acquisitions and buy-outs
Chapter 6B	Rights and liabilities in relation to Ch 6 and 6A matters
Chapter 6C	Information about ownership of listed companies and managed investment schemes

Chapter 6CA	Continuous disclosure
Chapter 6D	Fundraising
Chapter 7	Financial services and markets
Chapter 8	Mutual recognition of securities offers
Chapter 8A	Asia Region Funds Passport
Chapter 9	Miscellaneous
Chapter 10	Transitional provisions

Chapters 2A–2P and 6CA of the Corporations Act, along with Ch 1 (which contains rules for interpreting and applying the Act) and 9 (which includes some of the consequences of contravening the Act), make up the core of Australia's company law and are the focus of this book. The operation of Ch 6, 6A, 6B, 6C, 6D and 7 (takeovers, fundraising, and financial services and markets) is explained in Chapters 21 and 22. Chapters 24 and 25 explain the key features of Ch 5 (external administration).

OTHER SOURCES OF COMPANY LAW

[¶2-300] Overview

In addition to the Corporations Act, company law rules can be found in:

- case law (or 'precedent')
- the Corporations Regulations
- the ASIC Act
- ASIC exemptions, modifications and guidelines
- the accounting standards
- the ASX Listing Rules.

Each of these important sources of company law is described below.

[¶2-310] What is case law?

Case law is another important source of the rules that govern companies. Australia has a 'common law' system of law in which the recorded decisions of courts operate as binding statements[12] of the way in which statutory provisions are to be interpreted. Those decisions may also themselves be a source of legal rules not recorded or recorded fully in legislation.[13]

That is, case law (or 'precedent') can be a source of both:

12 Under the doctrine of 'precedent', a decision of a superior court (that is, a court ranked above another in the hierarchy of courts) binds a lower court. This means that, if a judge or panel of judges in a superior court has stated that, for example, a provision of a statute should be interpreted in a particular way, judges in lower courts must also adopt that interpretation. The High Court of Australia is the most superior of all Australian courts. Its decisions bind all other Australian courts.

13 The process of recording legal rules in legislation is called 'codification'. Civil law systems such as those found in many European and Asian countries have fully or almost fully codified laws.

- additional binding rules of law that are not contained in the Corporations Act
- binding statements governing interpretation of the provisions of the Corporations Act.

How do we use case law to find legal rules?

Many students have difficulty using case law to interpret legislation or to find additional legal rules. Under the Australian system of law, judges can only make decisions on the issues brought before them by the parties to the litigation and on the particular facts of the case presented to them.[14] The system is an adversarial one, in which the parties to the litigation are responsible for discovering and presenting the facts to the court, and preparing arguments about the way in which the law should be applied.

The judgment will generally contain an outline of the facts presented to the judge, a summary of the opposing legal arguments put by the parties, and the judge's decision on what the correct law is and how it should be applied to the particular facts before the court. The judge's decision is only a statement of the law as it applies to the particular facts before the court.

In later cases that deal with similar issues, lawyers take the reasoning applied by the judge in the earlier judgment and argue either that the facts of the later case are so similar to those in the earlier judgment that the same outcome should result, or that the facts are so different that a different approach should be adopted.[15]

Case law therefore operates as a guide to what the law is, or how it should be applied, when the facts in issue are similar to the ones on which an earlier, binding decision has been reached.

Some important characteristics of case law

Case law is 'reactive' in the sense that courts must wait for parties who have a disagreement to come before them to ask for an adjudication on an issue. This means its coverage is essentially piecemeal — that is, if no one has brought a dispute on an issue before a court, there will be no applicable case law. This has two important implications for company law:

1. Company law by its nature often involves commercial disputes. Because of delays and costs in litigation, commercial parties will often prefer to come to an arrangement privately to settle disputes without going to court.
2. There is often a considerable delay between the time at which a new provision is included in the Corporations Act and the time at which (if ever) it comes before the courts for interpretation.

As seen throughout this book, there are a number of key provisions of the Corporations Act on which there is little or no applicable case law.

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14 Sometimes judges will include in their reasons for judgment opinions about matters not directly in issue. For example, a judge may express a view about what the applicable law would be if the facts of the case were different. These statements are referred to as *obiter dicta* (that is, a remark made in passing) and are not binding (although they may be persuasive) in later cases.

15 Alternatively, the lawyers may argue that the earlier judgment was incorrectly decided.

[¶2-320] What are the Corporations Regulations?

Additional rules, including rules relating to more mechanical, administrative matters, are set out in the Corporations Regulations. The Corporations Regulations are arranged in Chapters that mirror those of the Corporations Act. The Regulations prescribe, for example, the content of the various forms that are required to be lodged with ASIC or used under the Corporations Act. However, the Regulations are not limited to administrative or procedural matters and in some areas do affect the operation of the principal Act.

[¶2-330] What is the ASIC Act?

The *Australian Securities and Investments Commission Act 2001* (ASIC Act) is the Act that establishes ASIC and confers upon it its powers to administer the Corporations Act and police the activities of companies. ASIC's role in the administration of company, securities and financial services law is explained in ¶2-520 below.

The ASIC Act contains a number of important provisions relating to corporate regulation, the financial reporting system and consumer protection in the financial sector.

In the area of **corporate regulation**, the ASIC Act provides for the establishment and operation of ASIC, and confers upon ASIC its powers to undertake investigations and gather information. It also establishes a number of bodies connected with the administration of company law, including the:

- Parliamentary Joint Committee on Corporations and Financial Services (which oversees the operations of ASIC)
- Takeovers Panel (which conducts hearings to determine if unacceptable conduct has occurred in relation to takeovers and other acquisitions of shares)
- Companies Auditors and Liquidators Disciplinary Board (which deals with disciplinary matters relating to the duties and functions of auditors and liquidators).

In relation to the **financial reporting system**, the ASIC Act facilitates the development of accounting standards and auditing and assurance standards, and provides for the operation of the:

- Financial Reporting Council (which is responsible for broad oversight of the standard-setting process and monitoring the operation of accounting standards)
- Australian Accounting Standards Board (which makes accounting standards for use by companies)
- Auditing and Assurance Standards Board (which makes auditing and assurance standards).

The **consumer protection laws** governing the financial sector are contained in Div 2, Pt 2 of the ASIC Act. The Part makes particular conduct in relation to financial products and financial services unlawful — it covers (among other things) unfair contract terms, unconscionable conduct, misleading or deceptive conduct, and unlawful sales practices. The rules correspond in large part to the consumer protection laws that apply to the rest of the economy (other than the financial sector) under the Australian Consumer Law. ASIC has responsibility for regulation in this area in relation to the financial sector, while

the Australian Competition and Consumer Commission and the State and Territory Fair Trading Offices look after the rest of the economy.

[¶2-340] Why are ASIC Regulatory Guides and Instruments important?

In determining which rules apply to a proposed corporate action, the participants in, or advisers to, a company may need to consider any exemptions from, modifications to, or guidelines for interpreting the Corporations Act granted or laid down by ASIC.

ASIC modifications and exemptions

ASIC is given the power, under the Corporations Act, to modify the application of, or grant exemptions from, certain parts of the Act to individual applicants or classes of applicants. ASIC, in its discretion, can modify, or grant exemptions from, many provisions of the Act, including those relating to:

- public issues of debentures, under Pt 2L.7
- financial reports and audit, under Pt 2M.6
- takeovers, under s 655A
- public issues of securities, under s 741.

The effect of an order made by ASIC under these powers is to alter the law as it applies to the person the subject of the order. That is, the ASIC instrument has the effect of amending the law in that particular situation.

ASIC has made over 100 instruments that alter the law in this way. Until 2015 these instruments were known as *class orders* but now they are called ASIC Legislative Instruments. They apply, without the need for a separate application by each company, to all companies falling within the class described. ASIC can also make 'one-off' orders for special relief on the application of a single company.

In ascertaining the rules that apply to a proposed corporate action governed by any of these provisions, company participants and their advisers will need to determine whether:

- exemptions from or modifications of the relevant provisions have been granted by ASIC instrument, or
- whether it is possible and desirable to apply to ASIC for relief from the operation of those provisions in the company's individual circumstances.

ASIC has issued Regulatory Guides that set out the policy guidelines in accordance with which it will exercise its discretion in these matters.

ASIC Regulatory Guides

ASIC has issued a large number of policy documents and other guidance that, while not having force of law, indicate the manner in which ASIC proposes to interpret the law and exercise its regulatory powers and discretions. The Regulatory Guides are available on the ASIC website at www.asic.gov.au.

[¶2-350] Why are accounting standards relevant?

As explained later in Chapter 17, companies are required to keep financial records relating to their affairs, and some companies who are required to prepare *financial reports* (including financial statements) have those reports audited, lodge copies of them with ASIC and send copies to members.

Section 296 of the Corporations Act requires that, except in certain limited circumstances, the financial report must comply with the accounting standards. The accounting standards are defined in Pt 2M.5 of the Corporations Act and are standards made by the Australian Accounting Standards Board (AASB).

Knowing and understanding the accounting standards is important for reporting companies, not only in the preparation of their financial reports but also in the planning stage of corporate transactions.

[¶2-360] What are the ASX Listing Rules?

As noted in Chapter 1, some companies are 'listed' companies — that is, their securities are listed for quotation on the public stock market conducted by the ASX. The ASX is a private company (not a government body) that provides a trading facility for securities issued by companies listed on it. Listing means that securities issued by the company can be bought and sold by investors through a public and transparent market. The reasons for listing and its consequences are discussed in Chapter 4.

When they list, companies agree as part of a contract with ASX that they will comply with rules imposed under the ASX Listing Rules. These rules are additional to those imposed on companies by the Corporations Act. The Listing Rules cover a variety of matters, such as imposing additional disclosure requirements and imposing additional requirements that a company must meet before the company enters into certain types of transactions or issues new securities. The purpose of the Listing Rules is to ensure that the market for listed companies' securities is transparent, liquid and informed, and that the interests of the companies' public shareholders are protected.

Only listed companies and their participants (and in some cases, entities controlled by listed companies) are required to comply with the Listing Rules.

The Listing Rules are 'additional and complementary to companies' common law and statutory obligations'.[16] If a company or its participants breach the Listing Rules, ASX can remove or suspend that company's securities from quotation.[17]

While the Listing Rules essentially operate as private law that is binding only as a matter of contract between the ASX and the listed company, they do have some statutory, public law force. This is because s 793C of the Corporations Act gives the courts the power, on the application of ASIC, the ASX or a 'person aggrieved', to order any person obliged to comply with the Listing Rules (which may include the company, its directors

16 Foreword to the ASX Listing Rules.

17 This sanction is not always an appropriate one, because of the very serious harm that can be done to investors in the company by removing their means of disposing of their shares.

and officers, and its controlled entities) to do so. If the person then fails to comply with the Listing Rules, that person will be in contempt of the order of the court.

Where the ASX Listing Rules impose additional requirements on listed companies relevant to the matters discussed in this book, those Listing Rules are discussed briefly.

APPLYING COMPANY LAW TO LEGAL PROBLEMS

[¶2-400] How do you use company law to answer a legal question?

The various types of company law rules referred to in this Chapter (sourced from the Corporations Act, case law, etc) can be used to answer a legal question in much the same way as other types of laws. Judges use the approach outlined below when writing their judgments. Equally, students who are studying law subjects — whether at law school or in a commerce degree — need to become familiar with this approach.

In many law subjects, assessment will include 'hypothetical' questions in an exam or skills assignment. The technique used for answering them is well established. Students at law schools in the United States quickly become familiar with this approach, known as the 'IRAC approach', which has the following elements:

- **I** = Issue
- **R** = Rule of law
- **A** = Application to the facts
- **C** = Conclusion

Issue: which issue or issues are involved in the question?

A 'hypothetical' question in an exam usually consists of about one page of facts and then a set of instructions (eg 'Advise Fred on whether he can sue Maria').

The facts will be designed to allow you to display your knowledge of the particular area of law under examination. It is possible, however, that not all the facts are relevant to answering the question. You must decide at this stage which particular part (or topic) of company law applies to the facts.

Rule of law: what precise legal rule or rules are relevant to the facts?

With your knowledge of the Corporations Act, case law containing company rules, and other sources of company law, you need to make a decision about which legal rule or rules are relevant to the facts before you. Having identified the right rule or legal principle, you need to state it clearly and state where it comes from. For example, you may want to consider a rule or procedure that comes from the Corporations Act. In this case you write down the correct section number (for example, if you are discussing the business judgment rule, you need to write 's 180(2)'). If you are discussing a principle that comes from a decision of a court (for example, where a court has indicated how a rule is to be interpreted or applied) you must state the name of the case. This is referred to as 'authority' and is crucial in legal reasoning and writing.

Application of the rule: how does it apply to the facts of the problem?

You will then need to 'apply the law to the facts'. This is a very important step. Sometimes there will be a clear-cut answer. On other occasions the answer will not be clear-cut and you may have to argue 'both sides of the argument' in your answer. Even if the question asks you to advise only one party, you will need to explain both sides of the argument if the answer is not clear-cut.

Conclusion

You should come to a conclusion based on your argument. It is a good technique to fix your conclusion firmly in your mind and then make sure that each step of your argument is targeted at that conclusion.

REGULATION OF COMPANIES

[¶2-500] Overview

Company law is made up of a combination of legal rules that facilitate the use of companies as vehicles for commercial enterprise, and legal rules that regulate the activities of companies and their participants. The regulation of companies and their participants involves making laws (a function of parliament), administering those laws (a function of the Commonwealth Treasurer and ASIC) and resolving disputes under those laws (a function of courts).

Companies that choose to list on the ASX agree to subject themselves to the ASX Listing Rules. The ASX has a role to play in supervising and enforcing compliance with the Listing Rules.

This part examines the role of ASIC, the ASX and the courts in company law.

[¶2-520] What is ASIC?

The Australian Securities and Investments Commission (ASIC) is the main regulator of companies and the body responsible for carrying out the administrative functions set out in the Corporations Act. It is established and operates under the ASIC Act. ASIC's operations fall within the ministerial responsibility of the Commonwealth Treasurer.

ASIC is an independent Commonwealth government body which has regulated financial markets, securities, futures and corporations since January 1991. From 1998, ASIC became responsible for consumer protection in superannuation, insurance, deposit taking and, from 2002, credit. In 2010, ASIC's responsibilities were expanded to include:

- supervision of trading on Australia's licensed equity, derivative and futures market (taking over this function from ASX from 1 August 2010)
- regulation of consumer credit and finance broking (referred by the states with effect from 1 July 2010)
- licensing of traditional trustee companies (from May 2010).

ASIC's mandate expanded further in 2012 and 2013 to include responsibility for the national business names register and OTC derivatives markets.

The breadth of ASIC's mandate is illustrated in Figure 2.1.

Figure 2.1 Additions to ASIC's Mandate

Source: The ASIC Capability Review Panel, *Fit for the future – A Capability Review of ASIC*, p35 (footnotes omitted)

ASIC's *Annual Report 2018–19* provides a snapshot of the entities it regulates and its operations. It is reproduced in Table 2.2.[18]

18 ASIC *Annual Report 2018/19*, pp. 264–265.

Table 2.2 Five-year summary of key stakeholder data, 2013–18

Business data	2018–19	2017–18	2016–17	2015–16	2014–15
Companies (total)	2.7m	2.6m	2.5m	2.4m	2.2m
New companies registered	223,661	244,510	249,394	246,051	235,182
AFS licensees	6,159	6,170	6,058	5,511	5,198
Authorised market infrastructure providers[1]	64	65	67	52	50
Registered company auditors	3,962	4,226	4,365	4,483	4,596
Registered liquidators	651	663	711	707	711
Registered managed investment schemes	3,712	3,726	3,632	3,619	3,642
Credit licensees	5,188	5,503	5,576	5,726	5,779
Fundraising documents lodged	794	898	1,017	891	1,078
Control transactions – schemes and bids	73	60	72	64	78
Control transactions – schemes and bids implied target size	$34.3bn	$32bn	$18bn	$34.8bn	$27.4bn
Fundraising where ASIC required additional disclosure	$3.2bn	$3.5bn	$7.2bn	$6.4bn	$9.4bn
Recoveries, costs, compensation, fines or assets frozen	$77.7m	$437.8m	$849.7m	$217.4m	$61.1m
% successful criminal and civil litigations	94%	99%	90%	96%	85%
Criminal and civil litigation and administrative actions concluded[2]	192	138	220	181	167
Criminals imprisoned	10	6	13	13	12
Reports of crime or misconduct finalised	10,249	9,567	9,011	9,751	9,669
Total searches of ASIC databases	142,6m	122.5m	90.6m	90.7m	86.2m
Business names (total)	2.3m	2.2m	2.2m	2.1m	2.2m
New business names registered	375,052	366,181	348,266	337,413	327,687
Registered SMSF auditors	5,919	6,039	6,339	6,671	6,669
% company data lodged on time	94.6%	94.6%	94.6%	95%	96%

Business data	2018–19	2017–18	2016–17	2015–16	2014–15
Fees and charges collected for the Commonwealth	$1,273m	$1,227m	$920m	$876m	$824m
Employees (average FTEs)[3]	1,701	1,656	1,640	1,627	1,609

1. We changed the methodology for reporting the number of authorised market infrastructure providers in 2016–17. This figure now includes exempt financial markets, licensed clearing and settlement (CS) facilities, exempt CS facilities, licensed trade repositories and credit rating agencies in addition to domestic and overseas financial markets.

2. Excludes summary prosecutions for strict liability offences.

3. Net average number over 12 months on net FTE basis (i.e. excluding FTEs working on capital projects).

What is the structure of ASIC?

ASIC consists of a chairman and not less than three and no more than eight individual commission members.[19] Until 2009, the commission typically had three full-time members. The number was increased in 2009 and in 2019 ASIC had seven six members (including the chairman). The members are chosen by the government. ASIC's full time equivalent staff is about 1,700.

Responsibility for the different aspects of ASIC's role is divided internally by the commission's staff. Organisational details are provided on ASIC's website (www.asic.gov.au).

What are ASIC's main functions?

A significant part of ASIC's resources are devoted to the regulation of financial markets and to consumer protection functions in relation to the financial system generally. A detailed discussion of those responsibilities is beyond the scope of this book; emphasis is instead placed on ASIC's functions in relation to the regulation of companies.

19 Section 9 of the ASIC Act.

ASIC's main functions in connection with the regulation of companies are:

- ***Registering companies***. When a person wants to form a new company, or change the status of an existing company, that person lodges a registration application with ASIC. ASIC enters the proposed new company on its register of companies, and by that process, the company is incorporated.[20]
- ***Gathering and disseminating information about companies***. Companies are required to provide certain information about their participants, their operations and their financial affairs to ASIC. ASIC maintains a record of that information and makes the information available (through a 'company search') to people interested in the company.[21]
- ***Educating companies and individuals about the law***. ASIC issues Regulatory Guides and other publications which are designed to help people understand and comply with the Corporations Act.
- ***Modifying the Corporations Act in certain circumstances***. As noted in ¶2-340, ASIC has the power to modify the operation of, or grant exemptions from, certain provisions of the Corporations Act in certain circumstances. In this way, the law can be adjusted to take account of special circumstances, without the need to include in the Corporations Act special arrangements to deal with every possible contingency or unusual circumstance, however remote or unlikely.
- ***Registering company auditors and liquidators***. ASIC is responsible for registering persons qualified to act as auditors or liquidators of companies.
- ***Investigating breaches of the law***. ASIC has both informal and formal powers to investigate suspected breaches of the Corporations Act. Often, these investigations occur as a result of a person complaining to ASIC.
- ***Enforcing the law***. ASIC can enforce the law by taking certain administrative action (for example, revoking a licence or issuing a banning order), by bringing an action for breach of the civil penalty provisions under Pt 9.4B of the Corporations Act, by bringing civil proceedings under s 50 of the ASIC Act on behalf of persons harmed by breaches of the Corporations Act or by referring a breach to the Commonwealth Director of Public Prosecutions for criminal prosecution.[22]

In performing its functions and exercising its powers, ASIC is required by legislation to strive to meet the objectives set out in s 1(2) of the ASIC Act. These objectives include:

- maintaining, facilitating and improving the performance of the financial system and the companies and other entities within that system in the interests of commercial certainty, reducing business costs, and the efficiency and development of the economy
- promoting the confident and informed participation of investors and consumers in the financial system.

20 See Chapter 5 for a discussion of the procedure for registering companies.

21 The information collected by ASIC, and the means for accessing it, are discussed in Chapter 17.

22 ASIC's enforcement powers are described further in Chapter 15.

[¶2-540] What is ASX's regulatory role?

As noted in Chapter 1, some companies elect to have their securities listed for quotation on the stock market conducted by the ASX. When they do so, they contract with the ASX that they will comply with the Listing Rules. The ASX acts as a 'regulator' in the sense that it polices compliance by listed companies with those rules.

However, it is important to remember that the ASX is a private, for-profit company, not a governmental or regulatory agency.

Section 792D of the Corporations Act requires the ASX to cooperate with ASIC in the performance of ASIC's functions. This may include providing information to ASIC about listed companies or the activities of participants in the securities markets. In addition, the ASX must notify ASIC if it believes that a person is breaching the Listing Rules or the Corporations Act. Sometimes a breach of the Listing Rules may be grounds for ASIC to commence an investigation of the listed company.

[¶2-560] What courts have jurisdiction in corporations matters?

Companies are legal persons capable of suing and being sued in their own name — that is, they can be the plaintiff or defendant in a civil proceeding, or a defendant in a criminal proceeding. The following writings review the jurisdiction of courts over companies, explaining which courts are allowed to hear matters in which companies are involved.

What courts have jurisdiction over companies generally?

In matters other than those arising under the Corporations Act, companies are subject to the ordinary jurisdictional rules. For example, an action to recover a debt would be brought in the state court system, in either a lower court (like the Magistrates (or Local) Court or the County (or District) Court) or a superior court (a state Supreme Court) depending on the amount of money involved and the current rules setting out the monetary limits for jurisdiction for courts in the relevant state. The same would be true for tort claims, such as claims by or against the company for negligence.

Claims under particular statutes such as the *Competition and Consumer Act 2010* (Cth)[23] are brought in the court having jurisdiction under the relevant Act. In the case of actions under the Competition and Consumer Act, for example, the Federal Court has jurisdiction.

What courts have jurisdiction over matters arising under the Corporations Act?

Matters arising under the Corporations Act fall into two categories:

- actions for breach of a provision of the Corporations Act (criminal, civil penalty and civil)
- proceedings in accordance with the Corporations Act (such as an application for an order for winding up a company under s 471).

23 Formerly the *Trade Practices Act 1974* (Cth).

Which court has jurisdiction to hear or decide a matter under the Corporations Act depends on the particular matter. Some matters can be decided in the general court system (for example, by a Magistrates Court or District Court), subject to relevant jurisdictional limits. Other matters arising under the Corporations Act are expressly reserved to the Federal Court of Australia, the Family Court, or the state or territory Supreme Courts. Where a matter is reserved in this way, the relevant section of the Corporations Act will refer to 'the Court', rather than 'a court'.

Under the Corporations Act, civil jurisdiction is conferred by Div 1 of Pt 9.6A on the Federal Court and the state and territory Supreme Courts. This means that civil matters arising under the Corporations Act can be heard by any of these courts, subject to general legal rules about bringing cases in the most appropriate forum. Criminal jurisdiction is conferred by Div 2 of Pt 9.6A of the Corporations Act. Traditionally, the criminal courts of the states and territories have jurisdiction with respect to offences under the Corporations Act. However the Government announced in 2019 that it will give the Federal Court of Australia jurisdiction in respect of criminal matters.

CHAPTER 3

The Legal Nature of Companies

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The Separate Entity Doctrine

What is separate legal personality? ¶3-100

What happened in *Salomon's* case? ¶3-120

What are the consequences of treating the company as a separate legal entity? ¶3-140

Corporate Capacity

What do we mean by *corporate capacity*? ¶3-200

How do companies do things of legal effect? ¶3-220

How wide are the powers of companies? ¶3-240

What is the effect of any internal limitations on powers? ¶3-260

Limited Liability

What is limited liability? ¶3-300

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Piercing the Corporate Veil

How does the corporate veil operate in relation to tort claimants? ¶3-400

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In what circumstances have courts pierced the corporate veil? ¶3-440

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Corporate Liability
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On what basis can companies be liable for torts? ¶3-510
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[¶3-001] Introduction

Chapter 1 looked at the commercial and functional nature of companies and provided a broad overview of the structure and some of the key features of companies. This Chapter drills further into the idea of companies by looking particularly at the legal nature of companies.

Companies have two particularly significant legal characteristics or attributes that enable them to function as legal persons (that is, juristic entities capable of doing acts of legal effect) in their own right. These are:

- separate legal personality, and
- legal capacity.

A third important legal attribute of companies limited by shares is that the members of the company enjoy limited liability.

These attributes, and what they mean for companies, their participants and other people, are discussed in this Chapter.

There are some circumstances in which the law will 'look through' separate legal personality of a company, for example to treat assets or liabilities of the company as if they were assets or liabilities of the company's members. Lawyers refer to this (perhaps misleadingly in some respects) as 'piercing the corporate veil'. The circumstances in which the corporate veil might be pierced, and the implications of doing that, are also explored here.

As a legal person, a company can be held liable for criminal and civil wrongs. The final part of this Chapter explains how the law imposes liability on companies in these circumstances.

THE SEPARATE ENTITY DOCTRINE

[¶3-100] What is separate legal personality?

The law treats a company as being a separate person from its members and those who manage its operations. This is the doctrine of separate legal personality.

The central distinguishing characteristic of a company is that it is treated as a separate person from its participants. This means that the company can incur and receive obligations and hold property in its own name. For example, a company can lend or borrow money, enter into contracts with its participants and with outsiders such as suppliers and customers, be the registered proprietor of land and own chattels (personal property), be a

lessee or lessor, operate a bank account and take out insurance, and act as trustee of a trust in its own right. The company can be the plaintiff or the defendant in civil proceedings, and in certain cases may be the defendant in criminal prosecutions. The rights it holds and the obligations it incurs are the company's own, not those of its managers, the people who have invested in it or its employees.

One judge described the doctrine of separate legal personality in 1923 in the following terms:

> Between the investor, who participates as a shareholder, and the undertaking carried on, the law imposes another person, real though artificial, the company itself, and the business carried on is the business of the company, and the capital it employs is its capital and not in either case the business or the capital of the shareholders. Assuming, of course, that the company is duly formed and is not a sham (of which there is no suggestion here), the idea that it is a mere machinery for effecting the purposes of the shareholders is a layman's fallacy. It is a figure of speech, which cannot alter the legal aspects of the facts.[1]

The fact that the company is treated as a separate person from its participants means that the company continues unchanged even if the identity of the participants in it changes. It also means that the company can enter into legal relationships with its participants, for example as debtor and creditor or as employee and employer. If the company and its participants were not separate legal persons, these relationships would not be possible.

In addition, companies are treated as separate entities liable for income tax under the *Income Tax Assessment Act 1936* (Cth) (the ITAA).

The separate legal personality of companies was recognised and affirmed in the famous 19th century decision of the English House of Lords in *Salomon v Salomon & Co Ltd*. This case is recognised as one of the most important cases in company law.[2]

[¶3-120] What happened in *Salomon's* case?

The fact that a company was a legal entity separate from its participants was affirmed just over 100 years ago in the leading case of *Salomon v Salomon & Co Ltd*.[3]

What are the facts in *Salomon's* case?

Mr Salomon ran a boot manufacturing business as a sole trader. After the business was established, Mr Salomon incorporated a company in which he and members of his family were the only shareholders, and he sold the business to the company. The company paid Mr Salomon part of the purchase price for the business immediately (in the form of shares in the capital of the company) and agreed to pay the remainder over time. To secure its obligation to pay, the company gave Mr Salomon security over its assets in the form of a company charge.[4]

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1 *Gas Lighting Improvement Co Ltd* v *IRC* [1923] AC 723 at 740–741, per Sumner LJ.

2 The definition of 'person' in s 6 of the ITAA includes companies. If a company derives income, it is a 'taxpayer' assessable to pay income tax.

3 [1897] AC 22.

4 Company charges are explained in Chapter 18.

The effect of the charge was that the company's assets had to be used to pay out Mr Salomon in full before they could be applied to pay out the company's other unsecured creditors.

Mr Salomon controlled the company by holding almost all the shares in the company and also through his appointment as its managing director, and through an agreement with the members of his family that they would exercise their rights to participate in the management of the company in accordance with his directions.

What was the legal issue in *Salomon's* case?

When the company's business failed, the value of the assets was insufficient to pay out both Mr Salomon and the company's other creditors. The creditors argued that Mr Salomon should not receive the benefit of the charge (giving him the right to be paid in priority to them), because the degree of control he exercised over the company meant it should be treated as being his agent, or trustee for him, in the conduct of the business. If the company were Mr Salomon's agent, or were operating the business as trustee for him, he would have been required to indemnify the company for the debts it had incurred.

What did the court decide?

The case is significant because the House of Lords held that, despite the fact that Mr Salomon controlled the company, it was not his agent or trustee. The company was treated as operating the business in its own right and as being separate from its controller, Mr Salomon. Therefore, the charge given by the company to Mr Salomon was valid and he was entitled to be paid his debt, even though other creditors of the company would not be paid because the company had insufficient assets to pay all its creditors.

The fact that a company is a separate entity from its controllers was emphasised in the context of corporate groups[5] by the High Court in its decisions in *Industrial Equity Ltd v Blackburn*[6] and *Walker v Wimbourne*.[7]

[¶3-140] What are the consequences of treating the company as a separate legal entity?

The consequences of treating the company as a separate person from its participants include the following.

- ***A company's obligations and liabilities are its own, and not those of its participants.*** Where a company incurs a contractual obligation or a liability in tort, that obligation or liability is the company's and not an obligation or liability of its members or officers. Because companies are separate entities, creditors of a company are generally unable to look to the participants in the company to pay the company's debts.[8]

5 Corporate groups are discussed in Chapter 4.

6 (1977–1978) CLC ¶40-370; (1977) 137 CLR 567.

7 (1975–1976) CLC ¶40-251; (1976) 137 CLR 1 at 6–7, per Mason J.

8 There are exceptions to this general rule. Creditors may be able to recover money owed to them by a company from the company's directors or shareholders in certain circumstances.

- ***A company can sue and be sued in its own name.*** Section 119 of the *Corporations Act 2001* (Cth) (Corporations Act) provides that, when a company is registered, it 'comes into existence as a body corporate'. As such, from that time it can sue or be sued in its own name. This means that it is not necessary for the members of the company or its officers to be named as parties to the legal proceedings where the proceedings only involve the company.
- ***A company has perpetual succession.*** This means that the company is a continuing entity in law with its own identity regardless of changes in its membership. It continues in existence, unchanged, even if its original members die, sell their shares to others or otherwise cease to participate as shareholders. The company continues in existence until it is de-registered under the statutory procedure set out in the Corporations Act.
- ***A company's property is not the property of its participants.*** Unlike the beneficiaries of a trust, the participants in a company have no proprietary (legal or equitable) interest in the company's property. They therefore have no 'ownership' rights in respect of it.

Macaura v Northern Assurance Co Ltd is an example of this principle. In this case,[9] Mr Macaura transferred his interest 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. When the timber was destroyed by fire, the insurance company refused to pay out under his policy because he did not have an 'insurable interest' in the timber as he was not its owner. The company was the owner of the timber.

- ***A company can contract with its controlling participants.*** Because they are separate legal entities, a company and its participants can enter into contracts with each other. For example, as seen from *Salomon's* case, a company can lend money to or borrow money from its controlling shareholder.

In *Lee v Lee's Air Farming Ltd*,[10] the controlling shareholder and managing director of a company that operated a business which involved aerial top-dressing of farmland was killed in a flying accident. His widow successfully argued that she was entitled to a payout under workers compensation insurance for her husband's death because her husband was a 'worker', that is, he had entered into a contract of service with the company. Unless the company and its controller were separate legal entities, the finding that a contract existed between them would not be open to the court, because a contract requires at least two separate parties.

9 [1925] AC 619.

10 [1961] AC 12.

CORPORATE CAPACITY

[¶3-200] What do we mean by *corporate capacity*?

The foregoing explains the fundamental principle of company law that a company is separate from its participants. Here we examine more closely the principle that a company is a *legal* person, that is, an entity that (although artificial) is recognised by the law as being capable of interacting with others in a manner that has legal effect.

Companies' ability to do acts of legal effect is referred to as their *capacity*. Companies have the legal ability to do most things that a natural person can do and some additional things. Their capacity is conferred by s 124 of the Corporations Act, which is discussed below. A company's constitution may include internal limitations on its permitted activities, but these do not affect the validity of its acts.

[¶3-220] How do companies do things of legal effect?

As described in the following writings, companies have the legal capacity to do most of the things that a natural person can do and some additional things (such as issue shares) that they need to do because they are companies.

Companies, of course, are an abstraction. They do not have any physical identity and are incapable of 'doing' acts in a physical sense. For example, a company does not have a hand with which it can sign a contract. Companies must act through natural persons, such as their officers or members.

Chapter 6 explains that companies can act directly through one of the organs of the company (the board of directors or the members in general meeting), acting within the scope of their respective powers. Companies can also act indirectly through their agents, appointed under the principles of agency law. The manner in which companies enter into binding contracts with others is explained in Chapter 23.

[¶3-240] How wide are the powers of companies?

When a new company is created by registration, the Corporations Act confers on that company power to do acts that have legal effect. In many respects, the capacity of a company to do acts having legal effect is the same as that of a natural person.

Section 124 of the Corporations Act gives a company the legal capacity and powers of a natural person. This means that a company can do anything that a natural person can do, such as enter into contracts and hold property, although the company's capacity does not extend to things that, by their nature as artificial persons, companies are unable to do (such as marry or appear in person — that is, without a legal representative — before a court): see *Simto Resources Ltd v Normandy Capital Ltd*.[11] In addition, companies have certain powers that natural persons do not have, such as the power to issue shares and debentures.

11 (1993) 11 ACLC 856; 10 ACSR 776.

The approach taken in s 124 confers wide powers on a company. Not all corporations have such wide powers. In the case of many statutory corporations, their powers will be limited to doing acts related to the purpose for which they were established. For example, the Australian Securities and Investments Commission (ASIC) is a body corporate[12] and its powers are limited to 'whatever is necessary for or in connection with, or reasonably incidental to, the performance of its functions',[13] which include the functions described in Chapter 2 of this book.[14] If ASIC attempted to do something that was not necessary for the performance of its functions, that act would be of no legal effect by operation of a legal rule known as *ultra vires*.[15] Therefore, a company registered under the Corporations Act has wider powers than many other types of corporations.[16]

[¶3-260] What is the effect of any internal limitations on powers?

The fact that a company has such wide powers may not suit all of its participants. For example, the members of a joint venture company (in which neither member has control of the company) may wish to restrict the company's activities to particular, pre-agreed objects. To this end, participants in companies may agree between themselves that the company will limit its activities in certain ways.

By including such restrictions in the company's constitution, those restrictions will bind not only those who agree to them at the time, but also the company and any person who becomes a member or officer of the company at a later time.[17]

Such restrictions are envisaged by s 125(1) of the Corporations Act, which provides that 'if a company has a constitution, it may contain an express restriction on, or a prohibition of, the company's exercise of any of its powers'. Under s 125(2), 'if a company has a constitution, it may set out the company's objects'. The intention of participants in including an objects clause in the constitution may be that the company's activities be restricted to things consistent with or incidental to those objects.

In the case where a company does have provisions in its constitution limiting its objects or restricting or prohibiting the exercise of any of its powers, what is the effect of an act by the company that is outside the scope of those restrictions?

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12 *Australian Securities and Investments Commission Act 2001* (Cth) (ASIC Act), s 8.

13 ASIC Act, s 11(4).

14 ASIC is a statutory corporation formed under the ASIC Act and its powers are conferred by s 11–12A of the ASIC Act.

15 Literally, 'beyond power'.

16 Before 1 January 1984, companies did not have the wide powers now conferred on them by s 124 of the Corporations Act. Then, companies only had power to do what was necessary for, connective with, or incidental to the attainment of particular purposes set out in the company's memorandum of association (which at that time made up part of what is now the company's constitution). In order to confer upon companies the widest possible capacity, it became the practice of lawyers to draft long objects clauses, dealing with every possible activity they could imagine, for inclusion in a company's memorandum of association. Occasionally, you will still see older companies with memoranda of association that include such clauses. Their effect is discussed below.

17 This is because a company's constitution operates as a statutory contract binding on all its participants, under s 140. The constitution is discussed in detail in Chapter 5.

Section 125(1) states that 'the exercise of a power by the company is not invalid merely because it is contrary to an express restriction or prohibition in the company's constitution'. Section 125(2) states that 'an act of the company is not invalid merely because it is contrary to or beyond any objects in the company's constitution'. The intention of these provisions is to abolish the doctrine of *ultra vires* as it applies to companies, so that third parties that deal with companies can enforce obligations incurred by companies, even where those obligations were incurred in breach of these internal restrictions.[18]

However, there can be consequences resulting from acts which are outside restrictions in the company's constitution. Such acts may amount to a breach of the statutory contract represented by the company's constitution. The effect of breaches of a company's constitution is discussed in Chapter 5. Causing the company to do something inconsistent with these restrictions may also amount to a breach of duty or other wrongful conduct on the part of the person (such as a director) who caused the company to do the act, and consequences may attach for that breach. Directors' duties are discussed in Chapters 11–14.

LIMITED LIABILITY

[¶3-300] What is limited liability?

Companies limited by shares have an additional legal attribute that is significant to their use as a form of business organisation — the liability of the members to contribute to the debts of the company is limited to the amount (if any) remaining unpaid on their shares. This is referred to as limited liability.

Limited liability means that a member of a company limited by shares is usually not required to contribute amounts from their personal wealth beyond the subscription price of their shares to meet the debts of the company.

The liability of members to contribute

In a company limited by shares, the initial members of the company subscribe for shares that represent a claim against the company and to which certain rights (such as control rights and distribution rights) attach. Members who join the company after its initial registration may do so by subscribing for new shares in the company or by acquiring already issued shares from another member.

Subscription for shares involves the person who wishes to become a member of the company paying an amount of money (referred to as the issue price or subscription amount) to the company in return for the share. The issue price is determined by the directors at the time they decide to issue the new share.

18 It should be noted that both s 125(1) and 125(2) state that an act or the exercise of a power of a company is not invalid *merely* because it is outside the restrictions imposed by the constitution. This suggests that other conduct of a person dealing with a company may affect the validity of the act. In particular, if a person dealing with a company has been aware that the act was inconsistent with the restrictions contained in the constitution, any contract may be voidable as against that person at the option of the company.

When a new share is issued by a company, the directors may require payment in full of the issue price, or may allow the member to pay part of the issue price at the time of issue and the remainder at some time in the future. A share issued on this basis is called a partly paid share.

What is the underlying principle?

The underlying principle of limited liability is that a member who holds a share in a company is not required to contribute to the company to meet the debts of the company, beyond the amount initially subscribed, or agreed to be subscribed, for the share. This principle is reflected in the definition of 'company limited by shares' contained in s 9 of the Corporations Act, as 'a company formed on the principle of having the liability of its members limited to the amount (if any) unpaid on the shares respectively held by them'.

Where a member holds a fully paid share, that member is not required merely because of that membership to contribute any further amount to the company to cover the company's debts in the event that the company's own assets are insufficient to do so. Where a member holds a partly paid share, that member is required to pay the balance of the issue price to the company when the company makes a call on the member to do so.

Generally speaking, the amount contributed by members by way of subscription for share capital is intended to remain in the company for the duration of its operations. Members will be entitled to a return of their capital prior to winding up only in certain limited circumstances. In particular, they will not be entitled to a return of capital where it results in insolvency. On winding up, members can expect a return of their capital only if the company has sufficient assets, once all its debts are discharged, to do so.

[¶3-320] What is the rationale for limited liability?

As illustrated in Chapter 1, limited liability granted by statute is a relatively recent phenomenon in Anglo-Australian company law, dating only from 1855. The effect of limited liability is to transfer the risk of corporate failure from the investors in the venture carried on by the company to its creditors.

In *Edwards v Attorney-General of New South Wales*,[19] a case arising out of the arrangements put in place by the James Hardie group to fund compensation payments to asbestos victims, Young CJ summarised the purpose of limited liability in the following terms:

> Up until 1855 in England, when the Limited Liability Act was enacted, British business was at a distinct disadvantage because people were not prepared to take the risk of being liable for unlimited contributions where an entrepreneurial scheme failed. There were some avenues open to secure limited liability, such as registering the company in France and including a complex limited liability clause to the deed of settlement … The Limited Liability Act … the forerunner of the modern law, set up a system whereby people could simply by registering

19 (2004) 22 ACLC 1,177 at [74]–[77]; 50 ACSR 122.

> with the appropriate official, create a new corporate entity with limited liability, trade and take risks in advancing the economy of the nation without the consequence of losing everything if the venture failed.
>
> The purpose of the Corporations Act and its predecessor was for permitting the economy to be advantaged by such entrepreneurial ventures with limited liability and to regulate the rights of members inter se [and] the rights between members and creditors of corporations.
>
> As time went on, it was realised that fraudsters could manipulate the system so as to perpetrate fraud and exceptions were placed against limited liability such as liability for trading while insolvent. Nonetheless the essential purpose of the Act remains.

Because of the principle of limited liability, if a company fails, the investors' loss will be limited to the amount initially subscribed, or agreed to be subscribed, to the company. This may be as little as a few dollars, perhaps even less. Creditors of the company may lose all or substantially all of the money owed to them. This is because, once the company's assets are exhausted, the principle of limited liability prevents the creditors from looking to any of the participants in the company to make up any shortfall.

So it is important to remember that limited liability is a privilege conferred by law on members of a company limited by shares. Limited liability is said to:[20]

- encourage risk taking and entrepreneurial behaviour by enabling investors to quarantine their wealth from particular risky undertakings.
- decrease the need for shareholders to monitor the managers of companies in which they invest, because the financial consequences of company failure are limited. Shareholders may have neither the incentive (particularly if they have only a small shareholding) nor the expertise to monitor the actions of managers. The potential costs of operating companies are reduced because limited liability makes shareholder diversification and passivity a more rational strategy.
- provide incentives for managers to act efficiently and in the interests of shareholders by promoting the free transfer of shares. This argument has two parts to it. First, the free transfer of shares is promoted by limited liability because, under this principle, the wealth of other shareholders is irrelevant. If a principle of unlimited liability applied, the value of shares would be determined partly by the wealth of shareholders. In other words, the price at which an individual shareholder might purchase a share would be determined in part by the wealth of that shareholder, which would now be at risk because of unlimited liability. The second part of the argument (that limited liability provides managers with incentives to act efficiently and in the interests of shareholders) is derived from the fact that if a company is being managed inefficiently, shareholders can be expected to be selling their shares at a discount to the price which would exist if the company were being managed efficiently. This creates the possibility of a takeover of the company and the replacement of the incumbent management.

20 These reasons are drawn from F Easterbrook and D Fischel, *The Economic Structure of Corporate Law* (1991), p 41–44.

- assist the efficient operation of the securities markets because, as was observed in the preceding point, the prices at which shares trade do not depend upon an evaluation of the wealth of individual shareholders.
- permit efficient diversification by shareholders, which in turn allows shareholders to reduce their individual risk. If a principle of unlimited liability applied and a shareholder could lose his or her entire wealth by reason of the failure of one company, shareholders would have an incentive to minimise the number of shares held in different companies and insist on a higher return from their investment because of the higher risk they would face. Consequently, limited liability not only allows diversification but permits companies to raise capital at lower costs because of the reduced risk faced by shareholders.
- facilitate optimal investment decisions by managers. Limited liability provides incentives for shareholders to hold diversified portfolios. In these circumstances, managers should invest in projects with positive net present values, and can do so without exposing each shareholder to the loss of his or her personal wealth. However, if a principle of unlimited liability applied, managers may reject some investments with positive present values on the basis that the risk to shareholders is thereby reduced. 'By definition this would be a social loss, because projects with a positive net present value are beneficial uses of capital.'[21]

However, these benefits come at a cost. Perhaps, knowing that their personal assets are protected from claims against a company, the natural persons who run a company may be less careful than they would otherwise be, for example in matters of public safety. Persons who did not voluntarily choose to deal with a company with few assets, such as those who are harmed by a negligent act of a company, may be deprived of compensation.

[¶3-340] How is limited liability affected by contract?

Some creditors are not happy to deal with companies on the basis that they have no recourse to the assets of the company's participants in the event that the company fails. In these situations the creditor may want to enter into a separate agreement with a member or some other person, making that person responsible for a company's debts in certain circumstances. This would be a matter of contract between the particular member and the creditor.

Often, in the case of small companies, a major creditor such as a bank may ask the members of the company to provide a guarantee to the bank of the amount lent to the company. A guarantee is a promise to pay another person's debt if the other person refuses or is unable to do so. In this example, the members of the company would agree with the bank to pay the company's debt if the company is unable to do so from its own resources.

21 Ibid, p 44.

PIERCING THE CORPORATE VEIL

[¶3-400] How does the corporate veil operate in relation to tort claimants?

A person who is injured by another may be entitled to recover damages or compensation for their injury if the facts establish a valid legal claim under tort law (for example, the law of negligence). What happens where the defendant in such a claim is a company and the court orders that the company pay damages or some other form of compensation that exceeds the value of the company's assets?

One of the consequences of a company's separate legal personality is that its debts (including judgment debts) are its own and not those of its participants. The shareholders or managers of a company will not be required to make up the difference between the company's assets and the amount of the debt unless the court is prepared to depart from the general rule and pierce the corporate veil in one of the ways described below.

For example, imagine person X is injured by the negligence of a company, Y Pty Ltd. Y Pty Ltd has one shareholder who is very wealthy. X sues Y Pty Ltd and is awarded damages of $100,000. However, Y Pty Ltd only has assets of $2 and is not insured. In this case the maximum X could, in practice, recover from Y Pty Ltd is $2. Unless the courts are prepared to pierce the corporate veil, X would be unable to recover the remainder of the judgment from the wealthy shareholder.

The effect of the separate legal personality of companies on tort claimants is illustrated by the case of *Briggs v James Hardie & Co Pty Ltd*.[22]

In the *James Hardie* case, Mr Briggs was employed by a subsidiary of James Hardie & Co Pty Ltd that operated an asbestos mine. Mr Briggs contracted asbestosis and wanted to sue both the subsidiary (which was insolvent) and the parent company. To sue the parent company successfully, Mr Briggs would be required to pierce the corporate veil separating James Hardie from its subsidiary.

The matter went before the New South Wales Court of Appeal on a preliminary point. To win on this preliminary point, Mr Briggs needed to persuade the court that it was at least possible that a court considering the merits of the claim would find that there was sufficient evidence to pierce the corporate veil and hold the parent company liable for the acts and omissions of the subsidiary.

The Court of Appeal held that the matter should go forward. In the course of its decision, the court raised the possibility that different considerations should apply where the claim arises in tort rather than through a person voluntarily agreeing to deal with a company (as in cases involving breach of contract). Rogers AJA referred to a suggestion:

> ... that the real determinant in tort cases should be whether a corporation 'should be permitted to shift the risk and responsibility for such occurrences

22 (1989) 7 ACLC 841; 16 NSWLR 549.

> to the victims or the general public by operating the business as a corporation without sufficient capital or insurance to cover foreseeable risk.

However, the matter did not proceed beyond this preliminary stage, and the court was not required to reach a final decision on this point. In *James Hardie & Co Pty Ltd* v *Putt* (1998) 43 NSWLR 554, the Court of Appeal held that in the absence of evidence that a subsidiary company was a mere façade, the fact that a parent company exercised control and influence over its subsidiary did not of itself justify lifting the corporate veil so as to create a duty of care on the part of the parent company towards an employee of the subsidiary. This remains the law.

[¶3-420] How does the law mitigate the rigour of the separate entity doctrine?

Despite the general rule established by *Salomon's* case,[23] that a company and its participants must be treated as separate legal entities, courts are sometimes asked to 'pierce the corporate veil' and mitigate the rigour of the separate entity doctrine. One judge has said that principle, 'as best it can be identified, addresses the dishonest use of corporate vehicles to evade legal liability by fixing others with the liability evaded. The principle does not extend to holding the natural person who is the principal of a company liable for the contractual obligations of the company under a contract expressly entered into with the company alone'.[24]

This request may come from a creditor of the company, who wants a participant such as a major shareholder or director to be held liable for the company's debt. *Salomon's* case was an example of such a claim by creditors which was unsuccessful. Or it may come from the participants in the company itself, for example because they are seeking to establish some legal interest in the company's property, as was the situation in *Macaura's* case (see ¶3-140), where again the claim was unsuccessful.

However, in some cases the courts have been prepared to pierce the corporate veil and treat the company's rights, privileges, duties, liabilities or acts as those of its members. Incorporation does not fully 'cast a veil over the personality of a limited company through which the courts cannot see' (*Littlewoods Mail Order Stores Ltd v McGregor*),[25] and in some circumstances it will be appropriate for the court to look through the veil of incorporation to discover the identity of the participants in the company and impose liability upon them.

Further inroads have been made into the doctrine of separate legal personality by provisions of the Corporations Act itself, imposing liability for an insolvent company's debts on certain participants in some circumstances.

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23 *Salomon* v *Salomon & Co Ltd* [1897] AC 22; see ¶1-380.

24 *Davies v Apted* [2013] SASCFC 92 at [3] (Kourakis CJ).

25 [1969] 3 All ER 855, per Denning MR.

[¶3-440] In what circumstances have courts pierced the corporate veil?

As the law currently stands, it is only in exceptional circumstances that courts will pierce the corporate veil and treat a company's rights, privileges, duties, liabilities or acts as belonging to or being the responsibility of another. This may occur:

- at general law, where the corporate form is being used to avoid an existing legal duty; where the company is acting as the agent or partner of its controller; or where a particular law shows an intention that the corporate veil should be disregarded in applying it, or
- under statute, through the insolvent trading provisions.

It is important to remember that these circumstances represent exceptions to the general rule that each company must be treated as a separate legal person. In particular, the courts often note that a person cannot choose to use the corporate form where it suits them, and then later ask the courts to disregard the legal effect of that form:

> If people choose to conduct their affairs through the medium of corporations they are taking advantage of the fact that in law those corporations are separate legal entities, whose property and actions are in law not the property or actions of their incorporators or controlling shareholders. In my judgment controlling shareholders cannot, for all purposes beneficial to them, insist on the separate identity of such corporations but then be heard to say the contrary when [it is no longer in their interest].[26]

[¶3-460] When have courts pierced the corporate veil at general law?

On occasions, courts have been prepared to pierce the corporate veil so that, instead of the company remaining opaque, it can be looked into to discover its participants. There is no all-embracing principle as to when the corporate veil will be pierced.[27] However, it may be possible to group the decided cases under the following headings.

Where the corporate form is used to avoid an existing legal duty

It is usual and appropriate for persons forming a company to carry on business to do so for the purpose of limiting their personal liability for obligations or liabilities incurred in the future by the company in carrying on that business. This is one of the key rationales for using a company limited by shares to carry on a business. However, it is not lawful to form a company to avoid an *existing* legal obligation or liability, for example one under a contract.[28]

26 *Tate Access Floors Inc* v *Boswell* [1991] Ch 512 at 531, per Browne-Wilkinson VC.

27 RP Austin and IM Ramsay, *Ford, Austin and Ramsay's Principles of Corporations Law* (17th edn, 2018), [4.250].

28 A company cannot be formed with the intention of avoiding a public law obligation (such as a rule of criminal law or a regulatory standard) either. If a person formed a company for the purpose of carrying on an illegal or unlawful activity (that is, to break the law) with the intention that the company, and not the person themselves, would be liable for the consequences of the illegal or unlawful act, the company would be considered a sham and its incorporation would not be effective.