**Company Law Summary**

**Definition of a company** – An artificial entity recognised by the law as a legal person with rights and liabilities. It is regarded as an entity that is separate and distinct from its owners (shareholders/members) and managers (directors/officers).

**Proprietary Companies –**

Small companies that operate small-scale businesses

subject to minimum financial disclosure requirements.

**Public Companies** –

Permittied to raise capital from the public

To listed on the ASX must have more than 400 shareholders

Must also have either prescribed minimum amount of tanglible asset or operating a profitable business.

Detailed disclosure obligations through both ASX lisiting rules and Corporations Act

Active stock market enables investors to easily trade in listed shares therefore allowing high capital to be raised

**Limited Liability**

Gives investor limit liability when investing in companies which reduced the risk of loss to the amount investment.

Liquidity of being able to sell their interests in a company freely and transparent

**ASIC**

Main Commonwealth body responsible for administering the *Corporations Act 2001*

Body corporate with between 3 & 8 government-appointed members.

Ultimately responsible to the Commonwealth Treasurer and therefore Parliament.

**Objectives of ASIC**

**Functions of ASIC**

Monitoring and promoting market integrity and consumer protection:

In the Australian Financial System

Insurance & Superannuation Products

Financial Advising Licensees

Part 7.2 of Corporations Act operators of financial markets must be licensed by ASIC

Power to enforce listing rules of financial markets under s793C and s794D

Part 7.6 financial service providers must be licensed by ASIC

S741 gives ASIC wide power to grant exemptions in relation to the fundraising provisions.

**ASX**

Main stock market in Australia

Public Company Listed on its own exchange

Seeks to promote:

* Fair and well-informed market for financial securities
* An internationally competitive market

**Responsibilities –**

**Corporate Law Economic Reform Program Act 2004 (CLERP 9)**

Aimed to enhance audit regulation and the general corporate disclosure framework.

Amendents mainly to:

* Auditor independence requirements
* Strengthened obligations of auditors to report breaches of the law to ASIC
* Enhanced enforcement mechanisms in relation to continuous disclosure and the imposition of a duty on analysts to manage conflicts of interest

**Characteristics of a Company**

Companies are abstract, artificial entities recognised by the law as legal persons with rights and liabilities separate from their shareholders or members.

**Existence of a company – s119**

*(PAGE 81 of Legislation)* –

Company comes into existence as a body corporate at the beginning of the day on which it is registered with the name specified in its certificate of registration.

**Note:** On this day a NEW legal entity has been created

Legal entity is separate from its members

The assets of a company are not the assets of its members

Contracts entered into by the company will create rights and liabilities that

vest in the company and not in the members

**Effects of Registration**

Body Corporate – Legal entity created and recognised by the law.

Artifical persons as opposed to individuals who are natural persons

*Corporation* is also a body corporate (s57A(1) PAGE 54 of legislation)

**Legal capacity of a company – s124(1)**

*(Page 84 of Legislation)*

Capacity and powers of an individual and a body corporate

Power to acquire and dispose of property

Right to sue and be sued

**CASE**: **Foss v Harbottle**

Did not allow shareholders or members to sue on behalf of their company.

**RESULT**: *HOWEVER s236-242 of Corporations Act now permits a member or officer to bring legal proceedings in the companys names with prior leave of the court.*

*A company may sue and be sued by its own members.*

**S126(1) – Exercising company power to make contracts**

A company contract will be made by an individual acting with the companies express or implied authority and on behalf of the company.

Validity of the exercise of power by an individual to act on behalf of a company is determined by the law of agency and assumption **s129 – Power of an Individual to Make contracts.**

**Distinct Interest Property**

A company may own property distinct from the property of its shareholders and members.

This implies that shareholders do not have a proprietary interest in the property of the company.

**CASE**: **Macaura v Northern Assurance Co**

Shareholder only own shares in the company and a change in shareholders of a company will have no effect on its ownership of assets.

**Shareholders of a Company**

Shareholders may come and go but this does not affect the continuing legal personality of the company.

Even if all the shareholders of a company died this does not effect the continuation of the company.

**Limited Liability**

1. Means that shareholders of a company are not personally liable for their companies debts.
2. If a company has inccured obligations, it is primarly liable because its debts are separate from the debts of its shareholders. Only when the companmy has insufficient assets to pay its debt that the issue of whether shareholder liability arises.
3. A **company limited by shares** means that shareholders must pay the amount of debt on the shares they own and if the shares are fully own owe no further liability to pay the company **s 516 – Company Limited by Shares**

**MAIN EFFECT** of limited liability is that the risk of business failure is transferred from the companies shareholders to its creditors.

FOUR MAIN GOALS OF LIMITED LIABILITY –

**Small Companies Limited Liability**

1. Small numbers of shareholders who also function as directors and managers
2. No market for shares of unlisted groups companies and therefore no promotion of market efficiency
3. Limited liability encourages risk taking by parent companies because benefit of a business risk will accrue to the company while if the risk fails, the burden falls on the creditors.

**Impact of Limited Liability on Creditors**

Power of bargaining power generally means large creditors will not lend money unless they receive security for their loans

**Finance creditors** usually insist on

1. security in the form of personal guarantees from directors or shareholders
2. Insisiting on they inclusion of loan agreements of terms that restrict the borrowing company dividend policy, investment decisions that alter the risk characteristics of the company earnings and further debt capital.

**Trade creditors** bear a large part of risk of the debtor companies insolvency and can reduce this risk by charge higher prices for goods supplied and taking insurance to protect themselves.

**Company as a Separate Legal Entity**

**Salomon’s Case –**

1. Salomon was aboot maker who owned a large business as a sole trader and formed a proprietary company to give his sons a share
2. Salomon and two oldest sons were directors
3. The company purchased Salomon’s business for $39K which was excessive and Salmon held 20,001 shares and his family held the other 6 shares.
4. Business went sour, and Salmon borrowed $5K from a lender, Broderip, and gave him security over debentures purchased in the initial $39K.
5. Business failed and liquidator appointed and found assets valued at $6K and Broderip and Unsecured Creditors were owed $5K and $8K respectively.
6. Liquidator claimed that Salomon sold business for excessive amount and formation of Salomon & Co Ltd was fraud on its unsecured creditors.

**Decision**

1. House of Lords agreed with Salomon because:
   1. It was not contrary to the law at the time to gain limited liability and obtain priority as a debenture-holder over other creditors
   2. A person may sell a business to a limited liability company of which the person is the virtually the only shareholder and director
   3. Company was a separate legal entity distinct from its shareholders and director and was a secured debtor of its shareholders giving it rank ahead of its unsecured creditors.

CORPORATIONS ACT has ensured that a company can have one single shareholder into **s114 – Minimum of One Member (PAGE 79 of Legislation)**

**Lee v Lee’s Air Farming -**

1. Lee was a pilot who conducted an aerial topdressing business
2. Formed a company with capital of $3K one-pound shares of which 2,999 were allotted to him and 1 share to his solicitor
3. Workers compensation was taken out, naming Lee as an employee and he was killed in an aeroplane crash with his wife claiming compensation.
4. It was rejected because as Lee had full control of his company and could not be worker – i.e. could not be CEO, Director and Worker

**Decision**

1. Lord Morris said “One person may function in dual capacities and there is no reason to deny the possibility of contractual relationship being created as between the deceased and the company”

**Macaura v Northern Assurance Co Ltd -**

1. Owned land on which stood timber and sold the land and timber to a company he formed and received as consideration all the fully paid shares.
2. Company carried on business of felling and milling timber
3. Fire destroyed all the timber that had been felled and Macaura had only insured the timber loss by fire in his own name
4. He had not transferred the policy to the company

**Decision**

1. House of Lords agreed insurers were not liable as only the company and not Macaura could insure its property against loss or damage.
2. Shareholders have no legal or equitable interest in their companies property.

**Note**: **s17** of Insurance Contracts Act now ***overcomes the decision*** in this case by having an ‘insurable interest’ –

**Lifting the veil of incorporation**

1. Recognition that a company is a **separate legal entity** distinct from its shareholders is often expressed as the “veil of incorporation”.
2. **Once a company is incorporated, the courts do not usually look behind the “veil” to inquire why the company was formed or who really controls it.**
3. It also ensures that shareholders are not personally liable in limited liability companies as per **s516.**

**Statue**

**Insolvent Trading** –

1. Directors may be liable for debts incurred by their companies where directors have breached **s 588G – Directors Duty to prevent insolvent trading by a company (Page 451 Legislation)**
2. Pay compensation equal to the loss or damaged suffered by unsecured creditors in relation to the debted under s **588J, 588K, 588M (Page 453 of Legislation)**
3. Civil penalty pursuant to Pt 9.4B of Corporations Act
4. Criminal penalty under s588G(3)

**Uncommercial Transactions –**

1. Aim to ensure that such corporate insiders such as directors are treated differently to other who have dealings with the company by ensuring no preferential treatment from the company at the expense of the companies creditors
2. **s588FB – Uncommercial Transactions (Page 443 of Legislation)** is aimed preventing insolvent companies from disposing of assets prior to liquidation through uncommercial transactions which result in the recipient receiving a gift or obtaining a bargain that could not be explained by normal commercial practice.
3. Companies liquidators can set aside any uncommercial transactions entered into within two years of the commencement of windup up of the company **s588FE(3) – Voidable transactions (Page 445 of Legislation)**
4. If the recipient of the uncommercial transaction is a director or related entity of the company, the liquidator can avoid uncommercial transaction entered into within four years of the commencement of the wind up.

**Company officer charges**

1. **s 267 – Charges in favour of certain persons void in certain areas (Page 227 of legislation)** regards company officers who lend their company funds secured by a charge over its assets differently from secured loans by arms-length creditors.
2. An officer who has been granted a charge over company property is not within six months of its creation entitled to take any steps to enforce the charge without first obtaining the court permission.

**Financial assistance**

1. Where a company provides financial assistance for the acquisition of its own shares in contravention of **s260A – Financial Assistance by a company acquiring shares (Page 216 of legislation)** any persons involved in the contravention breaches the section and may be liable under the civil penalty provisions.
2. The company is not guilty of the offence **s260D (Page 218)**

**Common Law**

**Fraud**

**Re Darby**

1. Darby and Gyde formed a company which they were sole directors and together with five nominees were the shareholders
2. Company purchased a licence to work a quarry and then floated another company, Welsh Slate Quarries Ltd.
3. This was done for the purpose of purchasing the licence at a substantial overvalued price.
4. The new company issued shares and a prospectus to the public and paid Darby and Gyde for the licence whom divided the profits.
5. Welsh Slate Quarries Ltd then failed and the liquidator claimed for the secret profit as Darby was in breach of duty as a promoter of Welsh Slate Quarries.
6. Argued that the profit was made for Darby and Gyde Ltd and not for Darby himself.

**Decision**

1. This argument was rejected and Dary was ordered to disgorge his profit because the Welsh Slate was set up for the purpose of enabling fraud.
2. The court looked behind the façade of the legal entity.

**Fraud - Avoidance of legal obligations**

**Gilford Motor Co Ltd v Horne**

1. Horne was appointeed as managing director of Gilford Motor Co for a term of six years.
2. Service agreement provided that he was not to solicit or entice away from the company any of its customers during his appointment or after termination of his appointment.
3. 3 years later Horne resigned and started his own business in competition with the company attempting to take Gildford Motor Cos business.
4. Gilford Motor Co Ltd brought an action seeking to restrain Horne and the company he formed.

**Decision**

1. Action was successful and an injunction was granted against both Horne and the Company even though the company was not a party to the contract established with Horne
2. Ruled the company was established as a “cloak or sham” to enable contractual obligations to be avoided.

**Creasey v Breachwood Motors Ltd**

1. Creasey a sacked employee of Welwyn Ltd, commenced legal proceeds for wrongful dismissal.
2. Prior to the hearing Welwyn Ltd controllers caused it to cease operation and transferred its business and other asset to Breachwood Motors Ltd, another company they owned and controlled.
3. No assets were left for Creaseys claim in the event of it succeeding.

**Decision**

1. Creasey obtained judgement against Welwyn and court lifted corporate veil and held that Breachwood Motors Ltd was liable for the debt.

**Fraud – Involvement in directors breach of duty**

**Green v Bestobell Industries**

1. Green, the Victoria manager of Bestobell, incorporated his own company Clara Pty Ltd, in the tender process for certain construction works.
2. Without Bestobells knowledge or consent, Clara received the contract
3. When Bestobell found out it brought proceedings against both Green and Clara.

**Decision**

1. Green had breached his fiduciary duty to Bestobell by placing himself in a position where his duty the company conflicted with his own interests.
2. As Clara had knowingly participated in Greens breach, it was ordered to pay Bestobell for the profit it derived.

**Corporate Groups**

Use of companies within corporate groups which are controlled by a larger listed company. **These arrangements exist because – PAGE 35 BOTTOM/36 TOP**

**Application of Salomon’s Principle**

Each company in a corporate group is a separate legal entity from other companies in the group.

As a result:

1. Creditors of a company in a group can only enforce their rights against the debtor company
2. Shareholders of each group company have limited liability
3. Directors owe duties to the particular companies of which they are directors for and not the group as a whole
4. The controlling group can give directions to the other companies, but is not liable for the debts of the respective group companies.
5. Assets moved between companies can be transferred to other companies within the group and unsecured creditors of one company cannot claim assets which have been transferred.

**Corporate veil can be lifted sometimes so some of these cannot occur.**

**Walker v Wimborne – Directors moving funds**

1. Directors moved funds between the companies to enable various debts to be paid and used assets of one company as security for loans obtained by others.
2. Companies went into liquidation and the liquidator brought an action under **s598 – Order against person concerned with corporation** on the grounds that directors have breached numerous relationship to the corporation which resulted in the loss

**Decision**

1. Court rejected the argument that where companies were associated in a group, that directors could disregard their duties to individual companies in the group provided their actions were undertaken for the benefit of the group as a whole.
2. “In this respect it should be emphasised that the directors of a company in discharging their duty to the company must take account of the interest of its shareholders creditors. Any failure by the directosr to take into account the interests of creditors will have adverse consequences for the company as well as for them” –
3. Association between companies existed because each company had the same person as its director.

**Holding companies liability for insolvent trading by subsidiary –**

1. **S588V-588C** **(Page 455 of Legislation)** lift the viel of subsidiary companies by making holding companies liable for the debts of their insolvent subsidiaries.
2. If a holding company fails to prevent one of its subsidiaries from incurring debts while there were reasonable grounds to suspect that the subsidiary was insolvent, the subsidiary’s liquidators may recover from the holding company equal to the amount of loss or damage suffered by the subsidiaries unsecured creditors.

**Benefit of the group as a whole**

**Equiticorp Finance Ltd v Bank of New Zealand** agreed with **Walker v Wimborne** that directors owe separate duties to act in the best interest of each company.

**Consolidated financial statements**

1. **s 296 – Compliance with accounting standards and regulations** requires a companies financial report to comply with accounting standards.
2. **AASB 1024** requires that a company which is a chief entity must prepare consolidated financial statements for all entities that it controls
3. **Corporations Act** and **Accounting Standards (AASB)** recognise that the members of an economic entity function as one organisation.

**Subsidiaries as agents or partners**

*Smith Stone & Knight Ltd v Birmingham Corporation* argued the principal of a subsidiary acting as an agent for its holding company and court held that for a subsidiary to have an agency relationship with its holding company it must:

**Tort liability – \*\*\*\*\*\*\*\*\*\*\*\*\*\*ASSIGNEMENT\*\*\*\*\*\*\*\*\*\*\*\*\***

**Briggs v James Hardie & Co Pty Ltd**

1. Briggs suffered from asbestosis which he alleged he contract while being employed by a subsidiary of James Hardie & CO Pty Ltd
2. Briggs argued that the corporate veil of the subsidiary could be lifted to make the holding company liable

**Decision**

1. Court rejected as too simplistic the proposition that the corporate veil may be pierced where a holding company exercises complete dominion and control over a subsidiary.
2. It suggested that in decided whether to lift the veil in actions in tort – different considerations should apply:
   1. PAGE 40 MIDDLE
3. A controlling company may be held directly liable to an employee of its subsidiary on the basis that it owed a duty of care to the employee under the law of negligence. This duty may arise in the absence of a direct employment relationship and is most likely to arise where the controlling company exercises a higher degree of control over the day-to-day activities of its subsidiary out of which the tort claim arose **(Referred CSR Ltd v Wren)**
4. The degree of control of the controlling company over the activities of the subsidiary needs to be sufficiently strong so that the controlling company itself effectively conducted those activities and the subsidiary was merely a conduit or façade **(Referred CSR Ltd v Wren)**

**A company compared with partnership & trust**

**REFER EXCEL TABLE COMPARISON**

**Company Name**

**s 148 (1) (PAGE 94 of Legislation )–** Must have an ACN

**s 148 (2)** – Limited Companies must use LTD

**s 148 (3)** – Proprietary company must use PTY

**s 156** – Not carrying on a business using *Limited*, *No Liability* or *Propiertary*

**Cameron Real Pty Ltd v Cameron** restricted use of *Don and Mary Cameron Realty* *Pty Ltd* when *Cameron Real Estate Pty Ltd* was already in use in the same industry in the same area.

**S 52** of TPA – Engaging in misleading or deceptive conduct.

Trading under the same name may mislead or deceive consumers

**Availability of a Name**

**S 147 (1)** – Restrict use of names that are identical or unacceptable

**Reservation of a Name**

**S 152 (1) –** Allows reservation of a name of an intended company

**Change of Name**

**S 157 (1)** - A company may change its name and lodge this with ASIC

**S 157 (3)** – The new name must be available

**Display of Company Name**

**S 123 (1)** & s **153 (1)** – Set out its name follow by its CAN on its common seal and on all its public documents and negotiable instruments

**Registration Procedure**

**s 117(2)** - Application must contain this information

**s 142 (1) –** A company must have registered office in Australia

**REGISTRATION PROCEDURE \*\*\*\*\*\*\*IMPORTANT\*\*\*\*\*\*\***

**POST-REGISTRATION REQUIREMENTS \*\*\*\*\*\*\*IMPORTANT\*\*\*\*\*\*\***

**Corporations and Companies**

Corporation/Company defined in s57A – **Page 54 Legislation**

Building socities, Credit Unions and Incoporated associations formed under State or Territory Legislation do not have to be registered under the Corporations Act unless they do business OUTSIDE Their state.

**Coporations Act classifies companies in the following ways:**

**Liability of Companies s112(1) – PAGE 78 Legislation**

Limited by shares

~ Ability to raise funds by issuing shares to investors

~ Defined in s9 as a company formed on the principle of having the liability of its members limited to the amount unpaid on the shares respectively held by them.

~ Issue price for a share is determined by agreement between the company and the investor

~ Fully paid shares owe no more liability, partly paid shares owe the respective proportion of the unpaid amount

~ s515 (Page 411) states that a shareholder is liable to contribute to the companys property an amount sufficient to pay the companies debts and liabilities and the costs, charges and expenses of the winding up HOWEVER s516 states that a shareholder does not need to contribute more than the amount they owe if the company is limited by shares.

~ s520 (Page 411) will not be liable for any debt or liability of the company contracted after the past shareholder ceased to be a shareholder.

~ s 148(2) requires a company to have the word ‘Limited’ (or Ltd) at the end of its name

Limited by guarantee

~ s 9 defines a company limited by guarantee as a company formed on the principle of having the liability of its members limited to the respective amounts that the members undertake to contribute to the property of the company in the event of it being wound up.

~ Such a company does not have a share capital and members are not require to contribute capital while the company is operating.

~ If the company is wound up, members are liable to pay up to the amount specified as the members guarantees **(s117(2) – PAGE 80 of Legislation)**

**~** DRAWBACK that it does not raise initial or working capital from its members (useful for clubs, charities and non-trading companies whose capital needs can be met from outside sources)

~ s517 (Page 411) provides that members at the time of commencement of winding up need not contribute more than the amount they have undertaken to contribute to the companies property if it is wound up.

Unlimited Companies

~ s9 defined as a company whose members have no limit placed on their liability.

~ Members of unlimited companies are liable in a winding up for the debts of the companies without limit if the company has insufficient assets to meets its debts.

~ Similar to a partnership

No liability Companies

Usually for MINING COMPANIES

~ s162 **(Page 98 of Legislation – Changing Company Type)** – A public company may be registered as no liability or convert into one under the above section.

~ A no liability company is prohibited from engaging in activites that are outside its mining purposes objects (s 112 (3)).

~ The acceptance of shares in a no liability company does not constitute a contract by the shareholder to pay calls or contribute to the debts and liabilities of the company s 254M(2) **(Page 199 of Legislation)**

**~** Shares in a no liability company are issued on the basis that if the company is wound up, any surplus must be distributed among the shareholders in proportion to the number of shares held by them irrespective of the amounts paid up.

**Proprietary and Public Companies**

Refer to Excel Spreadsheet

**Holding and Subsidiary Companies –**

Refer to Excel Spreadsheet

**Disclosing Entities**

~ Definition in Part 1.2A of Corporations Act

~ s111AC (Page 61 Legislation) – A body is regarded as a disclosing entity if any of its securities (i.e. SHARES) are **Enhanced Disclosure Securities (EDS).**

~ **Enhanced Disclosure Securities**

~ Listed EDS must comply with ASX Listing Rules 3.1 – s674.

**Replaceable Rules**

~ Govern the internal administration and management of companies.

~ Company must be formed after July 1998 or those formed before which have repealed their constitutions s135(1)(a)(i) & (ii) (PAGE 88 Legislation)

~ Apply to both public and proprietary companies

~ s194 ( Page 119 of Legislation) deals with *proprietary company directors* voting at board meetings on matters involving directors personal interests.

**Table of Replaceable Rules**

IMPORTANT – Lists *Directors, Officers, Employees, Members* and *Shares* sections

**One Person Proprietary Companies**

~S 135(1) - Replaceable rules do not apply to proprietary companies with a single shareholder who is also the sole director.

~ Rules that do specifically apply to a single director are

**No liability companies/guarantee companies**

~ Most replaceable rules do not apply to these companies

~ s112(2) of No Liability requires mining companies to have constitutions

**Company Constitution**

~ s143 companies rules may comprise of a constitution specially drafted to suit a company’s particular needs, or the replace rules in the *Corporations Act* or combination.

~ If the company does decide to have a constitution, then it consists of one document.

**Statutory Requirements**

Companies can adopt a constitution in one of the following three ways:

1. **s136(1)(a)** - New company is regard as having adopted a constitution on registration, if all members agreed to having a constitution in place
2. **s136(1)(b)** –Company that is registered without a constitution can adopt one by passing a special resolution.
3. **s233 –** Court order made to adopt a constitution under s136(b)

**PUBLIC** companies must lodge their constitution with ASIC.

**Contents of Constitution**

~ Set out the governing matters such as:

1. The rights of members,
2. The conduct of members and directors meetings
3. Powers of Directors and their appointment and remuneration
4. Similar to replaceable rules

**Objects Clause**

**~ S125(2)** – Companies constitution may contain an objects clause that identifies and restricts the businesses and activities in which the company may engage.

~ Often depicted as a mission statement for shareholders and investors about business direction.

**Legal Capacity**

**S124(1)** – A company has the *legal capacity and powers of an individual* and this means that it is able to engage in any business or activity and may *acquire and exercise rights in the same way as a natural person*.

**S124(1)** – Also gives a company the **power of body corporate**:

* IMPORTANT

**S124(2) –** Companies legal capacity to do something is not affected by the fact that the companies interests are not served by doing a particular thing.

*NOTE: This section aims to protect outsiders by enabling them to enforce contracts with a company even though the contract involved an abuse of power by the companies directors or controlling shareholders.*

**Doctrine of Ultra Vires**

~ Companies once were limited to acting only within scope of Objects Clause

~ If it acted OUTSIDE this scope, **The Doctrine of Ultra Vires** stated that all contracts or transactions were void and had no legal effect as in *Ashbury Railway Carriage & Iron Co v Riche*

~ s 130(1) abolishes the **Doctrine of Constructive Notice** which implied that a person was taken to have information about a company if it is available. S130(1) implies that a person is not taken to have information about a company merely because the information is available to the public from ASIC.

~ **Doctrine of Ultra** was designed to protect shareholders and creditors as they were considered to have the right to expect that their capital was used only for the objectives stated in the Objects Clause.

~ Was abolished by both s124 & s125 because it allowed loopholes for both shareholders, creditors and the company to avoid contracts by using it. The *Corporations Act* does not require a company to have an objects clause in its constitution.

**Objects Clause contained in Constituion:**

If objects clause or an express restriction on exercise of a companies powers exists:

**S125(2) –** Provides that an act is not invalid merely because it is contrary to or beyond any of its objects

**S125(1) –** The exercise of power is not invalid merely because it is contrary to such an express restriction

**Failure to Comply with Constitution**

**S233 –** Failure to comply with constitution may be contrary to the interests of members as a whole or oppressive and allow a member to seek a remedy under this section.

**S461(1)(k) –** Allow a member to obtain an order for the winding up of the compoany on the just and equitable ground.

**Effect of Constitution and Replaceable Rules**

**Main purpose of s140** is to provide a way for the parties to the statutory contracts to enforce compliance with a company’s constitution and any replaceable rules that apply.

**S140** does not allow damages if breached but rather courts will enforce compliance with the constitution or applicable replaceable rules.

**S140(1)** – Provides that a companies constitution and any replaceable rules that apply to a company have the effect as a contract between:

1. The company and each member **s140(1)(a)**
2. The company and each director/secretary **s140(1)(b)**
3. A member and each other member **s140(1)(c)**

**Extension of Contract**

**S140(1) –** Provisions of the constitution have the effect of a contract between original members and signatories of the constitution and any person who becomes a member after the company was registered.

**S140(1) –** Contracts can be modified without the consent of all parties.

**s136(2) -** A company may modify or repeal its constitution, or a provision of its constitution by special resolution.

**Special Resolution – REFER BELOW**

**S136(2)** – Special resolution required it company wishes to adopt a constitution to modify or replace any replaceable rules that apply to it.

**S140(1)(a) & (c)** – Contracts are alterable and the alteration will bind even those members who voted against the modification

**S140(1)(b)** – Contract can be altered by special resolution by members and will equally bind companies directors & shareholders.

**Contracts between company and members**

**~ S140(1)(a)** provides that a companies constitution and applicable replaceable rules have effect as a contract between the company and each member.

~ Members can enforce only those provisions that confer rights on members in their capacity as members s140(1)(a),(b) & (c).

**Hickman v Kent or Romney Marsh Sheep-Breeders**

**Outline**

1. Hickman was a member of the Kent or Romney Marsh Sheep-Breeders Association
2. He began a court action complaining of various irregularities in the affairs of the association
3. Clause 49 of the Associations constitution stated that all disputes were to handled by arbitration

**Decision**

1. Court upheld constitution and stayed Hickmans Court Case
2. By virtue of the constitution the proceedings must take place as per Clause 49 of the constitution.

**Right to enforce provisions**

*Pender v Lushington* – Members have the right to enforce provisions in a constitution entitling them to have their votes counted at a general meeting.

**Right to be paid a dividend**

*Wood v Odessa Waterworks Co –* Right to enforce payment of a declared dividend

**Substantial Injustice**

**S1322(2)** – Enables the court to invalidate a procedural irregularity that causes substaintial injustice.

~ *Chew Investments Pty Ltd v General Corp of Australia Ltd*

**Outside Capacity**

~ Members cannot enforce provisions in the constitution that purport to give them rights in some other capacity than that of a member.

~ **s232** implies that a member need only prove that a breach is contrary to the interests of members a whole, oppressive or unfair in order to gain a remedy under this section.

**Eley v Positive Government Security Life Assurance Co**

1. Eley drafted constituted and stated that he was to be its permanent solicitor and could only be dismissed by misconduct.
2. No separate employment contract was entered into and he received an allotment of shares in consideration of the work done for the company
3. Company terminated his employment

**Decision**

1. Held that the constitution conferred no rights on a member where the member seeks to enforce a right in a capacity other than as a member.
2. Eley was seeking to assert a right in his capacity as a solicitor of the company and should have entered a separate contract independent of the constitution.

**Company & Non-members** –

**Contracts between members**

**~ S140(1)(c)** provides that the constitution has effect as a contract between a member and another member.

~ Assumes importance where a company’s constitution contains a pre-emption clause whereby such clauses give shareholders right of first refusal to buy other shareholders shares or to sell their own shares to the remaining shareholders as in *Carew-Reid v Public Trustee*

**Pty Pre-emption clause**

**S245D** – It gives the right to existing shareholders on the issue of additional shares.

Directors must offer issuing shares of a particular class to existing holders of

shares of that class.

~ Non-compliance with s245D would be in breach of the s140(1)(a) contract and no the s140(1)(c) because the shares are issued by directors on the companies behalf.

**Contracts between company & directors/secretary**

~ Common for directors to enter into separate contracts of service that are independent of the companies constitution and applicable rules.

~ If the constitution does not adequately provide a preocedure for removal of a director, the members can resolve to alter the constitution under **s136(1)** without exposing the company to liability for wrongful dismissal.

**No Separate Director Contract**

*Shuttleworth v Cox Bros & Co* removed a director whom was appointed for life, by altering the constitution and the court ruled that his position was subject to statutory power given to companies to alter their constitution and was allowed.

**Separate Director Contract**

The position is different if the director has entered into a separate contract with the company as the company cannot avoid its contractual obligations by altering its constitution as in *Allen v Gold Reefs of West Africa Ltd*. While S203C & s203D confirm the company has the power to remove a director, this does not deprive the director of any rights to compensation or damages.

**Remedies**

~ An injunction or declaration is the appropriate remedy where the complaint involves breach of s140(1)(a) or (c) contract as the member seeks to have the rules enforced.

~ Directors cannot prevent the company from terminating their appointment but can only obtain damages for wrongful dismissal as in *Southern Foundries Ltd v Shirlaw*

**Alteration of constitution and replaceable rules**

1. **s135(2) –** A company may displace or modify any one or more of the replaceable rules that applies to it by adopting a constitution
2. **s136(1)(b) –** A company adopts a constitution if it passes a special resolution to that effect (See above)
3. **s136(2) –** A special resolution is also required to modify or repeal a constitution or a provision of a constitution.

**Note:** If the entire constitution is repealed, the companies international management is governed by the replaceable rules.

1. **s9** defines “special resolution” as a resolution passed by at least 75% of the votes cast by members entitled to vote on the resolution.
2. **s249L(c)** - Requires the notice of the meeting at which a special resolution is proposed to set out an intention to propose the special resolution and state the resolution.
3. **s137(a) –** A special resolution takes effect on the date the resolution is passed.
4. **s136(5)** – Requires a public company to lodge to ASIC a copy of a special resolution within 14 days after it is passed

**Limits on right to alter constitution**

**Corporations Act**

**Entrenching Provisions**

**S136(3)** – Recognises that a companies constitution may contain provisions (entrenched provisions) that restrict the companies ability to modify or repeal its constitution by imposing further requirements for special resolution.

i.e. More than 75% of the voting required etc.

**Member Provisions**

**s140(2) –** A member is not bound by a modification of the constitution made after becoming a member so far that the modification:

* requires member to take more shares
* increases members liability towards share capital
* imposes or increases a restriction on the right to transfer shares already held

**Variation of Class Rights – Shares/Debentures**

Limitations on the power to alter a companies constitution when its share capital is divided into difference classes.

**Debentures**

**S245A(2)** – A company can issue preference shares only if certain rights attached to those shares are set out in the companies constitution or otherwise approved by special resolution.

**S246B-s246G** – Designed to restrict majority shareholders from varying or cancelling class rights.

**Oppression Remedy - IMPORTANT**

**S232 –** Enables members to apply to the court for a remedy if the majority of votes in favour a resolution alter the constitution/replaceable rules contary to members interests and are as a whole, oppressive, unfairly prejudicial or unfairly discriminatory to members.

**Common Law**

**Gambotto v WCP Ltd**

1. After successful takeover bid of WCP, bidder acquired over 99 percent of its share capital
2. Sought to alter WCP constitution to allow any member who has 90% of share capital to compulsorily acquire all other issued shares.
3. Justified on grounds of potential taxation and administrative cost savings.

**Decision**

1. *“Power to alter the articles should not be exercised simply for the purpose of securing some personal gain which does not arise out of the contemplated objects of power”*
2. Rejected “the benefit of the company as a whole test” and applied tests depending on whether or not an alteration involved “an actual or effective expropriation of shares or of valuable rights attaching to shares”
3. Held than an alteration which did not involve an expropriation of shares was valid unless it was either beyond any purpose contemplated by the constitution or oppressive.
4. Valid only if the majority of shareholders proved it is:
   1. **For a proper purpose –** Ruled taxation and administration not proper purpose for expropriation
   2. **Fair in all the circumstances –** Was not considered fair.

**REFER BELOW**

**Proper Purpose**

1. In *Grey Eisdell Timms v Combined Auctions Pty Ltd* case (whereby *Grey* was trying to take over *Combined* and *Grey* altered constitution to limit shareholdings to no more then 10% of issued capital and to expropriate shares held by non-pawnbrokers) court used *Gambotto v WCP Ltd Case*
2. Decided that the expropriation would only be justified if the minorities continued shareholding would be detrimental to the company and expropriation was a reasonable means of eliminating this detriment.
3. Held that it was not justified because significant numbers of current members were not pawnbrokers meaning the alteration was not needed to protect the companies business and;
4. It was oppressive because it was a means of ensuring that the managing director obtained a controlling shareholding in the company.

**Fairness in all circumstances**

1. An alteration of constitution that involves an expropriation of shares must be fair as well as for a proper purpose - *Gambotto v WCP Ltd Case*
2. in *Gambotto v WCP Ltd Case* fairness involved 2 elements:
   1. Process of expropriation must be fair in that it requires the majority to disclose all relevant information leading up to alteration and shares to be valued independtly
   2. Price paid to the expropriated shareholders should take into account variety of factors including assets, market value, dividends and nature of the corporation and its future.

**Problems and Solutions from GAMBOTTO - IMPORTANT**

Decision in *Gambotto* created significant obstacles for majority shareholders seeking to expropriate minority shareholders and allowed for these shareholders to extract excessive amounts of information in takeover bids to drive up their payout.

Pts 6A.1 and 6A.2 inserted in 1999 strengthen the position of majority shareholders and make it easier for compulsory acquisitiosn to occur in a takeover and other situation.

**Directors**

**S9 – Definition of Director** - A person who is appointed to the position of director or alternate director regardless of the name given to their position.

A person who is not validly appointed as a director is also regard as a director if:

* They act in the position of a direct
* The directors are accustomed to act in accordance with the persons instructions or wishes

**S 249C** – Power to call meetings of a companies members

**S 251A(3)** – Signing minutes of meetings

**S 205B** – Notice to ASIC of change of address

**De Facto Directors**

A person who is not formally appointed to the office, but acts in the position as a director.

DFC of T v Austin – Claimed it was not practicable to formulate a general statement as to what constitutes acting as a director.

1. Relative to what was performed in the context of operations and circumstances of a company.
2. In smaller companies, individuals may make decisions that elevate them to the position of director without their knowledge.
3. What external agents to the company perceive a person to be held at in regards to being a director.
4. A person may be regarded as a de facto director if the person is the driving force behind the company business despite not having been formally appointed or continues to participate in the management of the company after the expiration of the term of appointment as a director.

**Shadow directors**

Persons whose instructions or wishes are customarily followed by the directors of the company.

A holding company may be a “shadow” director of a subsidiary if the directors of the subsidiary are nominee directors who customarily following the holding companies directors or instructions.

**Types of Directors**

**Managing Director –**

Impracticable for board to carry out day-to-day management, and so it delegates its management function to the managing director who is accountable to the board.

**S201J** – Directors may appoint one or more of themselves to the office of managing director

**S198C** – Managing director may be conferred with any of the powers that the directors can exercise

**Chair Directors–**

**S248E** – Directors may appoint a director to chair directors meetings

**S249U** – An individual may be elected by the directors to chair meetings of the companies members

**S251A(2)** – Minutes must be signed by the chair of the meeting or the chair of the next meeting

**S248G(2)** – Chairman has a casting vote at directors meetings

*Woonda Nominess Pty Ltd v Chng –* The essence of chairmanship is exercising procedural control over a meeting.

*Kelly v Wolstenholme –* Exercising procedural control over a general meeting may include:

1. Nominating who should speak
2. Dealing with the order of business
3. Putting questions to the meeting
4. Declaring resolutions to be carried or defeated
5. Asking general business and closing the general meeting

*Colorado Constructions Pty Ltd v Platus* **–** No chair was elected during a meeting, which erupted into a brawl and some directors left. A resolution was passed that was challenged, and because there wasn’t a chair – no resolution had occurred.

*AWA Ltd v Daniels* **–** The responsibilities of a chair were described as:

1. The chairman is responsible to a greater extent than any other director for the performance of the board as a whole and each member of it. The chairman has the primary responsibility of selecting matters and documents to be brought to the board’s attention, for formulating the policy of the board and promoting the position for the company.

*ASIC v Rich –* Provided an expansion:

1. The general performance of the board
2. Flow of financial information to the board
3. Establishment and maintenance of systems for information flow to the board
4. Employment of a finance director
5. Public announcement of information
6. Maintenance of cash reserves and group solvency
7. Making recommendations to the board as to prudent management of the group

**Executive and Non-executive Directors**

Executive directors – Full-time employees of the company whose main role is:

1. To take part in the day-to-day management of the companies business
2. Comprise the senior management of the company under the leadership of the CEO
3. In large companies, delegate substantial control of the companies activities to its management.

Non-executive directors – Not full-time employees of the company whose role is:

Bringing an independent view and judgement outside the broad perspective of the boards deliberations.

Consider the interests of the company as a whole and the general body of shareholders.

Help remove conflict or where the interests of management and the company as a whole diverge

Alternate Directors –

Nominee Directors –

**Functions and Powers of the board**

Powers are determined by the companies replaceable rules, the companies constitution and the Corporations Act.

Function – To Provide strategy guidance for the company and effective oversight of management.

**RESPONSILIBITIES**

**Power of Management**

S198A – The business of a company is to be managed by, or under the director of its directors who may exercise all the companies powers expect any powers that the Corporations Act or the companies constitution require the company to exercise in general meeting.

**POWERS OF THE BOARD**

Scope of power in s198A is very broad and includes *changing the direction of the company* or *selling the only business carried on by it*.

**Shareholder cannot override management decisions**

Shareholders cannot override the decisions and involve themselves in the management of their company.

*Automatic Self-Cleansing Filter Syndicate Co v Cunninghame –*

1. Directors were ordered by a general meeting to sell the companies property
2. Directors refused to do this, relying on a provision in the constitution similar to s198A
3. Members argued the constitution was subject to the overriding rule that the directors, as agents of the company, were obliged to follow the instructions of their principle, the company the will of the company being a resolution of the general meeting

*Decision*

Court rejected the member’s argument.

Directors of the general meeting were a nullity that could not be ignored by the directors

Constitution gave management powers to the board of directors, which included selling the company

The members could not interfere with the directors in this respect and they were contractually bound by the constitution.

*Strong v J Brough & Son (Strathfield) Pty Ltd* –

1. Principle applied in this case to prevent the general meeting attempting to override a decision of the board to bring legal actions against some of the directors.
2. Court held that the board of directors was properly exercising the powers of management vested in it by the constitution and the general meeting could not usurp this power.

**Separation of Ownership and Management**

Ownerships becomes vested in the members.

The separation of functions is an important distinction between companies and partnerships.

*Public Companies –*

Management vests in the board of directors.

It would become unworkable if the general meeting had the power to manage the company.

*General*

1. Separation of ownership and control raises the possibility that management will act in its own interests in ways which may not be in the interests of shareholders.
2. Development in corporate governance, reflects higher expectations by the public and investment community that greater efforts by made by listed public companies to develop structures and procedures to ensure management is effective, and acts in the interests of shareholders and adopts appropriate standards of corporate behaviour.

**Board Procedure –**

**Appointment of Directors – Refer Excel Summary for Public v Pty**

**S201B(1) –** Persons under the age of 18 years cannot be appointed as directors.

**S201A(1) & (2)** – At least one person must reside in Australia

*Consent*

**S117(5)** – Director must have consent when the application is lodged with ASIC

**S177(2)(d) & (f)** – Must have name, address etc.

*General meeting*

**S201G –** Directors may be made by a members resolution in a general meeting

*Casual Vacancies*

**S201H** – Makes provision for the directors to appoint other directors to fill a casual vacancy.

* + Occurs if a director dies, is unable to continue or resigns.

*Share qualification*

A company may require a director to have a certain shareholding in the company before undertaking their position.

**Disqualification from managing a corporation**

**S206B –** Automatically disqualifies a person from managing corporations if the person is convicted of serious criminal offences or becomes bankrupt.

**S206F** – Power to disqualify a person from managing corporations if the person was an officer of two or more companies that became insolvent.

*Purpose*

To deter for would-be offenders that seek to offend

Protects the public from being exposed to “persons who have offended and will re-offend if not restrained” – *Chew v NCSC*

*Managing a corporation*

**S206A** – A person is if they make decision which:

**PAGE 267 – IMPORTANT!**

*Automatic Disqualification*

A person is automatically disqualified from managing corporations if they are convicted of an offence that:

*Disqualification by court order*

**S206C(1)** – Gives the court the power to disqualify a person from managing corporations where a court has declared under s1317E that the person contravened a civil penalty provision.

*Failed Companies*

**S206D(1)** – Gives the court the power to disqualify a person from managing corporations for up to 20 years if within the last seven years the person has been an officer of two or more failed companies.

**S206E(1) –** Gives the court the power to disqualify a person from managing corporations if the person:

*ASIC Powers*

**S206F** – ASIC power to disqualify a person from managing corporations for up to five years.

*Cullen v Corporate Affairs Commission –*

1. Appropriate to disqualify a person under the predecessor of s206F.
2. Evidence indicated that a director of four failed companies had not met the standards that the community expected a director to reach.
3. Did not attempt to mitigate loss or remit group tax.

**Removal of Directors –**

**S203D –** Provides that members may by resolution remove a director before the expiration of their period in office. Removal in this manner is permitted despite anything to the contrary contained in the constitution or in a separate agreement between the director and the company.

**S230D(1)** – The effect of the removal does not take effect until a successor has been appointed.

This section attempts to give members of public companies some control over the positions of the board of directors.

**Corporate Governance**

1. How corporations are controlled and the accountability and control mechanisms to which they are subjected.
2. Mechanisms aim to ensure that the board is accountable to stakeholders, especially shareholders, and that management is accountable to the board.
3. System by which companies are directed and controlled
4. Determining how the objectives and policies of the company are set and achieved
5. How risk is monitored and assessed and how performance is optimised.

**Why is it important**

1. Assure that corporations use their capital efficiently
2. Ensure that corporations take into account the interests of a wide range of constituencies
3. Company boards are accountable to the company and its shareholders.
4. Create value and provide accountable and control systems commensurate with the risks involved.

**Regulation of Corporate Governance**

Mix of legal regulation and self-regulation

**ASX Corporate Governance Listing Rules**

1. Develop suitable framework for corporate governance which reflected international best practice, and could provide a practical guide for listed companies, investors and interested persons.
2. ASX LR 4.10.3 requires listed companies to provide a statement in their annual report disclosing the extent to which they have followed the best practice recommendations in Corporate Governance.

**Roles & Functions of the Board and Management**

The board should adopt a formal charter that details the board’s functions and responsibilities, and the division of roles and responsibilities between the board and management. These include:

1. Oversight of the company including its control and accountability systems
2. Appointing and removing the CEO
3. Input into, and final approval of corporate strategy and performance objectives
4. Reviewing and ratifying systems of risk management, internal compliance and control, codes of conduct and legal compliance
5. Monitoring performance of senior management
6. Approving and monitoring major capital transactions
7. Approving and monitoring financial and other reporting

**Audit Committee – Refer notes**

**Risk and Internal Control – Refer notes**

**Remuneration – Refer notes**

**Duty of Good Faith/Best Interests**

**S181(1)(a)** – Requires a director or other officer to exercise their powers and discharge their duties in good faith and in the best interests of the corporation.

**Good Faith –**

1. Good faith aspect of both the fiduciary and statutory duties and requires directors to genuinely believe that they are acting in the best interest of the company.
2. Directors will not comply with their duty merely because they have an honest belief that their actions are in the best interest of the company.
3. The duty also has an objective element

*Hutton v West Cork Railway Co –*

*Bona fides (good faith) cannot be the sole test, otherwise you might have a lunatic conducting the affairs of the company, and its money with both hands in a manner perfectly bona fide yet perfectly irrational.*

**Best interests of the company –**

The courts can take the view that the duty to act in good faith in the best interests of the company means that the directors must act in the best interests of the shareholders

*Greenhalgh v Arderne Cinemas Ltd* –

*“The phrase “the company as a whole”, does not (at any rate in such a case as the present) mean the company as a commercial entity distinct from the corporators: it means the corporators as a general body.”*

*Darvall v North Sydney Brick & Tile Co Ltd -*

Court considered that directors:

1. Should have regard to both the interests of present and future shareholders as well as the interests of the company as a commercial entity
2. *“In my view, it is proper to have regard to the interests of the members of the company, as well as having regard to the interests of the company as a commercial entity. Indeed, it is proper also to have regard to the interests of creditors of the company. I think it is proper to have regard to the interests of present and future members of the company, on the footy that it would be continued as a going concern”.*
3. Also held that the directors may act in what they consider to be the best interests of the company as a commercial entity even though this may not be in the short-term interests of the shareholders.
4. A company has legitimate interests in matters which extend beyond the companies business and the security of its assets. These may include ho its shareholders are, the price of its shares and achieving a proper understand of the companies business in the investment community. *(The secondary market)*

**Individual shareholders –**

Directors do not owe particular duties to any particular shareholder.

*Percival v Wright* –

1. Director of a company was approached by a shareholder wishing to sell his shares.
2. The Director agreed to buy them but did not disclose that there was an impending takeover bid at a substantially higher price.
3. Shareholder afterwards sought to rescind the contract for the sale of his shares on the basis that the director breached his fiduciary duty to him by failing to disclose the information concerning the impending takeover even thought it did not eventuate

**Decision**

1. Court rejected the shareholders claim. It held that directors only owe fiduciary duties to the company as a whole and not to individual shareholders.

*Brunninghausen v Glavanics – Opposite of Percival v Wright*

1. Company had two shareholders who were also its only directors
2. Galvanic, the minority shareholder, despite being a director, was not involved in the company’s management and had no access to its financial records.
3. After a falling out, Brunninghausen– who was the managing director and CEO - offered to buy all of Glavanic's shares. Brunninghausenhad been previously approached buy another company with a take over bid
4. Glavanic sold all this shares to Brunninghausen, who sold them onto the third party at a substantial profit.
5. Glavanic sued Brunninghausen for breach of fiduciary duty and claimed equitable compensation

**Decision**

1. Held that while a directors fiduciary duty were generally owed to the company and not individual shareholders, the nature of a transaction may give rise to a director owning fiduciary duties to a shareholder.
2. Brunninghausen possessed special knowledge acquired while managing the company which provided an opportunity to sell the companies business advantageously.
3. *“A fiduciary duty owed by directors to the shareholders where there are negotiations for a takeover or an acquisition of the companies undertaking would require the directors to loyally promote the joint interests of all shareholders.”*

*Peskin v Anderson –*

1. Special circumstances need to exist in order for difuciary duties to be owed by directors to individual members. The director needs to be brought into direct and close contact with individual members
2. A fiduciary duty to individual members does not arise where there are no dealings or contract between directors and members and the directors did not cause the members to act in a certain way which turned out to be detrimental to them.

**Different classes of shareholders**

*Mills v Mills* –

1. Held that the test of whether a director is acting in the interests of the company is not appropriate whereby the exercise of power by the directors may benefit one class of share over another.
2. It involves the question of what is fair as between the classes of shareholders.
3. Also stressed that while directors are required to act in the interests of the company, the law does not require them to *“live in an unreal region of detached altruism”*
4. If they are shareholders also, they cannot reasonably be expected to disregard their own interests.

**Nominee Directors –**

1. Nominee directors are appointed to represent sectional interests. They are often appointed to represent the interests of individual shareholders in a joint venture company or they may also be appointed to represent a majority shareholder, a class of shareholders etc
2. Nominee directors are expected to act in the interests of their appointors rather than the companies shareholders generally.

The fiduciary and statutory duties to act in good faith in the best interests of the company as a whole requires directors to act in the best interests of the shareholders as a collective group.

**Problems with Nominee Directors**

1. Difficulties arise in situations where a nominee director is appointed to represent the interests of particular persons. There may be problems in reconciling the nominee director’s duty to act in the interests of the appointor and the director’s duty to act in the interests of the company as a whole.
2. Nominee directors are permitted to act in the interests of their appointor provided that they honestly and reasonably believe that there is no conflict between the interests of their appointor and the interests of the company.

*Re Broadcasting Station 2BG Pty Ltd*

1. Fairfax, gain control of Broadcasting Station 2BG Pty Ltd, a company that owned a radio station. The newspaper publishing company appointed a number of directors to the board of 2GB to represent its interests.
2. One of the independent directors, who was also a shareholder, sought a remedy under a predecessor of s 232 alleging that the affairs of 2BG were being conduct in an oppressive manager.
3. The alleged oppression concerned the appointment of nominees to act solely in the interests of Fairfax, and their conduct in withholding information from fellow directors concerning negotiations carried on by Fairfax in seeking the continuation of the ratios broadcasting licence.

**Decision**

1. Held that no oppressive conduct occurred.
2. Found that Fairfax nominee directors would be likely to act and were expected by Fairfax to act in accordance with its wishes without close personal analysis of the issues
3. There was no evidence that the nominee directors believed that the interests of Fairfax diverged from the interests of the company as a whole.
4. While nominee directors may breach their duties if they act in a way that is not in the best interests of the company, this conclusions is not lightly reached.
5. *It is unrealistic to expected directors to approach each company problem with a completely open mind – this would put a nominee director in an impossible position.*

Nominee directors breach their duty where there is a clear conflict between the interests of the company and their appointor and the companies interests are scarified.

*Scottish Co-operative Wholesale Soc Ltd v Meyer*

1. The company was a subsidiary of the Scottish Co-operative Whole Society.
2. Minority shareholders held slight less than half the issued shares in the subsidiaries
3. Three directors of the subsidiary were appointed as nominees of the holding company and the other two represented the minority shareholders.
4. The subsidiary operated a profitable textile manufacturing business using yarn purchased from its holding company.
5. After a time, the Scottish Co-Operative Wholesale Society decided to operate its own textile manufacturing business and stopped supplying yarn to its subsidiary
6. As a result, the subsidiaries activities were severely curtailed.
7. Action of the holding company had the effect of preventing the subsidiaries minority shareholders from participating in the profits of the textile manufacturing business.

**Decision**

1. Held that subsidariys directors appointed by the holding company acted contrary to the interests of the shareholders as a whole by failing to defend it from the actions of the holding company.
2. Their failure to act, couple with the holding companies conduct, was regarded as oppressive under the English Equilavent of s 232.

*Bennets v Board of Fire Commissioners of New South Wales –*

Same decision as above. Court decided that:

*“A nominee director must put the interests of the company ahead of the interests of the appointor wherever a conflict arises”*

**Company Groups**

Wholly owned subsidiary

1. A holding company will usually appoint its nominees as directors of subsidiaries.
2. Nominee directors on the board of a subsidiary are required by the holding company to act in the best interests of the group of companies.
3. In most cases, the interests of the holding company and the interests of the subsidiary will generally correspond. However, where there is a conflict between the interests of a subsidiary and the group, nominee directors must act in the subsidiaries best interests and not in the interests of the group as a whole as stated in *Walker v Wimborne*

Non-wholly owned subsidiary

1. A holding companies nominees of on the board of a non-wholly owned subsidiary are in a more delicate position. They must balance the interests of the group with the interests of the subsidiaries shareholders generally including all minority shareholders.
2. Generally, the interests of non-wholly owned subsidiary companies and the wider interests of the group coincide. However, in the case where the various companies in the group are in financial difficulties – the movement of funds from one company to another group member may prejudice the interests of creditors of the transferring company.
3. It may be detrimental to the interests of minority shareholders if directors fail to act in the interests of a particular company, and instead treat the company as part of a group.

*Equiticorp Finance Ltd v BNZ –*

1. Funds were transferred from two companies in a group to satisfy the debt of a related company

**Decision**

1. Held that the dominant director of the group was justified in considering that the welfare of the group was intimately tied up with the welfare of the individual companies
2. The interests of the two companies were considered because provision as made for compensating them for the loss of the funds.
3. The transactions were jusitifed because the holding company of the group had guaranteed the debt which was repaid.
4. The alternative was possible disaster for the whole group including the two companies.

A transaction undertaken for the benefit of the group or some other member of the group may be permitted, if it is for the benefit of a particular company that assistance is to given to other companies with the group.

**S187 –** A director of a wholly-owned subsidiary will be taken to act in good faith in the best interests of the subsidiary:

1. Where the constitution of the subsidiary expressly authorises the director to act in the best interests of the holding company
2. Where the director acted in good faith in the best interests of the holding company
   1. In order to protect the interests of the subsidiaries creditors, the operation of s 187 is limited to situations where the subsidiary is solvent at the time the director acts and does not become insolvent.
3. CASAC report recommendation that s187 be extended so that directors of a solvent partly-owned group company should be permitted to act in the interests of the parent company if authorised by the minority shareholders of the partly-owned company
   1. Where that authorisation is given, all minority shareholders who did not vote in favour of the resolution should have the right to be brought out.

**Duty to exercise powers for proper purposes**

Fiduciary duty of directors requires them to exercise their power for proper purposes. Directors may breach this duty even if they honestly believe their actions are in the best interests of the company as a whole.

In cases where it is alleged that directors have exercised their powers from improper purposes, the court consider two matters:

1. The objective purpose for which the power was granted
2. The purpose which actually motivated the exercise of the power.
3. The onus of establishing that the directors acted improperly rests with those alleging the breach of duty – *Australia Metropolitan Life Assurance Co Ltd v Ure*
4. The courts are generally reluctant to interfere in the internal management of a company unless improper purposes are clearly demonstrated.
5. A director may be in breach of duty to exercise powers for a proper purpose even though they are not involved in the transaction.
   1. Duty is breached if the director disclosed a conflict of interest and abstained from voting but knew of the improper purpose of the other directors, and failed to take steps to prevent the transaction from proceeding.
6. s 181, directors and other officers are under a duty to act in good faith in the best interests of the corporation and for a proper purpose. Breach of this duty to exercise powers for a proper purpose attracts the civil penalty provisions and possibly criminal liability where dishonesty is involved.

**Issues of shares**

Most of the cases involving allegations of breach of directors duties to act for proper purposes have concerned the issue of shares by directors. The power to issue shares is ordinarily conferred for the purpose of raising capital for the company.

Directors breach their fiduciary and statutory duties to exercise their powers for a proper purpose if they issue shares to:

1. Maintain control of the companies management or majority shareholding
2. Defeat a takeover bid
3. Create or destroy the voting power of majority shareholders.

**S232** – Issuing shares for an improper purpose may also constitute oppressive or unfair conduct, and enable a shareholder to obtain a remedy under this section.

**Creating or Destroying a majority of voting power**

*Howard Smith LTD v Ampol Petroleum Ltd* –

1. Takeover battle for control of R W Miller Holdings. Major shareholders were two independent companies, Ampol Petroleum and Bulkships Ltd
2. Ampol and Bulkships decided to combine their holdings and made a joint takeover bid for all other Miller Shares
3. Howard Smith, a company friendly to Millers Board, made its own takeover bid offering a higher price and to give this takeover bid a chance of success, Millers Directors issued sufficient shares to it so as to reduce the Ampol-Bulkships majority shareholder to a minority position.
4. When the joint takeover companies challenged the bid, Millers directors argued they were motivated by the fact their company need urgent funds for debt repayments

**Decision**

1. Held that directors breached their duty and invalidated the share issue to Howard Smith.
2. Court did not believe the directors explanation of their reasons for the share issue were valid, and that in its opinion they were motivated primarily to reduce the combined majority shareholder of Ampol and Bulkships to a minority position in order to promote the Howard Smith takeover bid.
3. This was considered improper, even though Miller Shareholder could have received a higher price for their shares.
4. This even includes honestly believe their actions are in the best overall interests of the shareholders.

*Whitehouse v Carlton Hotel Pty Ltd*

1. Carlton Hotel was a family company controlled by the father who was its governing director which gave him the position to issue shares.
2. Father held “A” class shares, wife held “B” class shares which were giving voting rights on his death, and sons and daughters held “C” class shares which held no voting rights.
3. Parents divorced and daughters sided with mother, and sons with father. Father sought to issue more “B” shares to his sons, which was made without of his wife nor share register but was held in several companies annuals..
4. Father then fell ought with his sons and proposed to annul the allotment, which the sons argued and sought to rectify by having the shares affirmed.
5. Company argued that the issue of “B” class shares was invalid because the father as governing director, had issued them for the improper purpose of realigning the relative shareholdings on his death.

**Decision**

1. Court ruled with the company and agreed that the allotment was invalid as a result of the governing director’s breach of duty.
2. Court ruled that the decision was the same as *Howard Smith LTD v Ampol Petroleum Ltd*:
   1. *“It lies essentially in the distinction between indirect proprietorship and ultimate control the shareholders on the one hand and the powers of management entrusts to the directors on the other. It is simply no part of the function of the directors as such to favour one shareholder or group of shareholders by exercising a fiduciary power to allot shares for the purpose of diluting the voting power attaching to the issued shares held by some other shareholder or group of shareholders…that he directors will genuinely believe that what they are doing to manipulate the voting power is in the overall interests of the particular company”*

This case indicates even though directors may honestly believe a share issue is in the best interests of the company, it will be invalidated if it is motivated by their desire to manipulate control within the company.

**“BUT FOR” Test**

1. “But for” test, applied as a negative criterion of causation, is important in determining causation. Causation is the casual connection that must exist between the breaches of duty of care, and the damaged suffered.
2. Spigelman CJ “Causation, like any other fact, can be established by a process of inference which combines primary facts like “strands in a cable” rather than “links in a chain”” from *Seltsam Pty Ltd v Mcguiness*

*Exercising Director Power*

When directors exercise their powers to issue shares, they may be motivated by a number of purposes. This is particularly the case when the directors are themselves shareholders in the company.

The must exercise their power in the interests of their company, but in doing so they may also promote their own interests as shareholders to the detriment of other shareholders. The courts will not intervene unless it is established that thie motivating purpose is improper.

*Hannes v MJH Pty –*

1. Held that the motivating purpose and the real reason for a governing directors action’s to issue shares to himself and enter into a service agreement was self-interest, and the desire to derive additional personal benefits.
2. These motives, therefore, overshadowed the directors duties to act in the interests of the company.
3. The director breach his duty to act for a proper purpose

**Statutory duty to act in good faith and for a proper purpose – s 181**

1. S 181 outlines the fiduciary duty of directors acting in good faith and for a proper purpose.
2. This may be easily contravened even if the director believes they are acting in the companies best interests.
3. This is most evident when a director promotes their personal interests in a situation, above that of the companies interests.
4. Statutory duties contained in Ch 2D overlap whereby a director who causes:
   1. A company to enter into an agreement which confers unreasonable personal benefits on the director
   2. Fails to make adequate disclosure of the conflict of interests and acts “improperly” in regards to s 182
   3. Lacks good faith for the purposes of s 181

are all contained.

*ASIC v Adler –*

**Outline**

1. Subsidiary of HIH Insurance LTD provided an undocumented, unsecured $10 million dollar loan to Pacific Eagle Equity Pty Ltd, a company controlled by Alder.
2. Alder was also a non-executive director non-executive director, and through Alder Corporation, a substantial shareholder in HIH.
3. PEE became a trustee of Australian Equities Unit Trust which was controlled by Alder Corporation Ltd.
4. Under the trust Alder was entitled to 10% of the trusts income even though the $10 million was contributed by HIH. PEE used the $10 million for the following transactions:
   1. *$4million used to buy HIH shares on the stock market. Sold the shares at a $2million loss. Alder was “looked” to have bought the shares and supported HIH*
   2. *$4million was used to purchase unlisted technology shares.*
   3. *$2million was loaned by the trust to Alder and associated interests.*

**Decision**

1. Alder breached his duties as an officer of HIH and HIHC under s181 by reason of all these transactions.
2. s181 duty was breached where the interests of the company are put at risk by contraventions of other statutory provisions such as those dealing with related party transactions s208.
3. s181 does not require the director to gain a benefit from the conduct
4. s182 Using his position improperly and s183 using information improperly.

*Breaches*

*s181* & *s182* = 1317E breaches

s184(1) = Criminal Liability

**Duty to Retain Discretion**

*Thorby v Goldberg (1964)*

Directors may enter into contracts on behalf of the company, whereby they agree to vote in favour of a particular course of action if they properly consider this to be in the interests of the company at the time the agreement is entered into

**Director Duties**

Duty of directors to avoid a conflict of interests is strictly applied.

Duty is imposed because of the recognition of the frailty of human nature.

The duty is breached whether or not the directors had fraudulent motives or not.

*S181* – Breached when an officer fails to act in good faith in the best interests of the company or for a proper purpose.

S182/183 – Breached where the officer makes improper use of position or improper use of information within these sections.

**Fiduciary Duties**

Directors breach their fiduciary duty if they have undisclosed interests in transaction with their company

* Because they are then in a position where their personal interests conflict or may conflict with the companies interests.

*Transvaal Lands Co v New Belgium (Transvaal) Land & Development Co*

**Outline**

1. Samuel & Harvey were two directors of Transvaal Lands. Samuel was also director of New Belgium
2. Both owned shares in New Belgium. Samuel instated board purchase shares owned by New Belgium.
3. After share purchase, Transvaal discovered Samuel and Harvey interest in the company.

**Decision**

1. Samuel breached his fiduciary duty to that company even though he did not vote on the board’s resolution that agreed to the contract.
2. Harvey was also held to have conflicting interests even though his shareholding in New Belgium was only as a trustee.
   1. He was under duty to Transvaal Lands to make the best bargain he could for it in relation to the transaction.
   2. This conflicted with his duty to make the best bargain he could for the beneficiaries of the trust.

*South Australia v Clark* ***–***

1. Clark, managing director of SA Bank, had conflict of interest when he arranged for the bank to enter into a contract that indirectly benefited another company in which Clark was a director and shareholder.
2. Court held that Clark had breached his duty of care.

*R v Byrnes –*

1. DIRECTOR OF TWO COMPANIES! Use quote middle page

**Financial benefits to directors of public companies: Ch 2E**

***S207*** *– Page 316/317- IMPORTANT QUOTE* – Requiring member approval for giving financial benefits to related parties that could endanger those interests s207.

**S208(1)** – For a public company or entity it controls to give a financial benefit to a director or other related party it must:

* Obtain the approval of its members in the way set out in ss217-227
* Give the benefit within 15months after the approval

**Financial Benefit –**

**“Giving a financial benefit” –** Defined in s229.

1. Requires a broad interpretation in determining whether a financial benefit has been given, even if criminal and civil penalties may be involved.
2. s229(2) – May be given indirectly through interposed entities or by informal or unenforceable agreements.
3. May comprise the conferring of a financial advantage that does not involve payment of money

**S229(3)** – Giving of a financial benefit may include:

1. Giving or providing finance or property
2. Buying or selling an asset
3. Leasing an asset etc –

**Related parties –**

*S228* – Relating parties of a public company

**When member approval is NOT required –**

S210 – s216 – Transactions that would be reasonable in the circumstances if the parties were dealing at arm’s length or the terms were less favourable to the related party than arms length terms –s 210

**Approval Meeting**

Public company must call a shareholders meeting that will vote on a resolution to approve giving the financial benefit, and must lodge an application with ASIC at least 14 days before the notice is given to members- s281(1).

*Breaching s208* – Page 319

S208 – A contravention of s208 requirement does not affect the validity of any contract or transaction connected with the giving of the benefit. The public company or entity that it controls is not guilty of an offence – s209(1)(b).

Penalty Provision – s1317E.

*ASIC v Adler* case – PREVIOUS – “Alder was fully aware that the $10 million loan was not on reasonable arms length terms, having instigated it.”

**\*\*\*\*– CHAPTER 2E DIAGRAM – IMPORTANT\*\*\*\***

**Personal Profits arising from acting as director –**

Directors must be seen to act in good faith. Directors, then, cannot place themselves in a position where it may appear that they are motivated by considerations other than what is in the best interests of the company.

*Regal Hastings Ltd v Gulliver*

**Outline**

1. Owned a cinema in Hastings.
2. The directors wished to lease two other cinemas in the town and sell the whole business of the company as a going concern
3. Subsidiary company was formed for this purpose with capital of 5K $1 shares as the lessor requirement guarantee capital.
4. Company could only afford $2K work of shares, so remaining was allotted between four directors, the company solicitor & other persons nominated by the board of 500 shares each.
5. Decided that instead of selling the business, the purchasers would buy all the shares in Regal and the Subsidiary and the shareholders of the subsidiary maybe a profit of $3 per share.

**Decision**

1. Purchasers of the shares appointed new directors and took action against the former directors to seek the profit that was made
2. Held that four directors were liable to repay the profits they had made on the sale of their shares.
3. Case illustrates the far-reaching implications of the equitable principle that directors cannot make personal profit arising from their positions as directors.

Important Points from the Case

1. Directors would personally profited, acted in good faith and the company had not been deprived of a business opportunity because it did not have the required funds.
2. Company benefited as a result of the other shareholders taking up shares in the subsidiary.
3. The successful action only benefited the purchasers of Regal Hastings who contracted to pay an agreed price
4. Return of the profits meant Regal succeeded in obtaining a reduction from the contracted purchase price
5. s1318 – Permits the court to relieve an officer from any liability for negligence, default, breach of trust or breach of duty if it appears that he acted honestly and having regard to the circumstance of the case, he or she ought to fairly exercise.

**Improper Use of Position – s182 –***S182* – Prohibits officers or employees of a corporation from improperly using their position to gain an advantage for themselves or for any other person or to cause detriment to the corporation.

* Statutory version of the principle from Regal Hasting Ltd v Gulliver that directors are under a duty not to make undisclosed personal profits arising from their position
* It is wider in that it applies to employees as well as officers
* It is also breached if officers or employees improperly use their position to gain an advantage for others and this also extends to the chairman’s position in Regal Hasting Ltd v Gulliver, since a profit was made by him as a trustee for others.
* Civil penalties for breach of this section are outlined in s1317E.

**Improperly**

Term “improper:

1. Conduct that is inconsistent with the proper discharge of the duties, obligations and responsibilities of an officer *Grove v Flavel*
2. Officers make improper use of their position if they breach their fiduciary duties.
3. *Chew v R* director may act improperly even though the director considered they were acting in the best interests of the company as a whole and did not intent to act dishonestly.
4. There may also be an improper use of position if officers acted without authority *R v Brynes*

*R v Cook*

1. Chairman of a company improperly used his position to gain an advantage for himself when he arranged, without the authority of the board, for the company to transfer $200K from its bank account to a joint account he held with his wife.
2. Court rejected directors argument that it was in the best interests of the company because he was concerned that the companies bank accounts would be frozen by ASIC.

*Alder v ASIC (again)*

1. Alder contravened s182 when he arranged for part of HIHC’s $10 million loan to PEE to be used to acquire HIH shares on the stock exchange.
2. Alder improperly used his position as a director of HIH and officer of HIHC and director of PEE to gain an advantage for the Alder Corporation.

**Gaining an advantage/Causing Detriment –**

S182 – An officer or employee must not only improperly use their position but must also do so to gain an advantage for themselves or for another person or to cause detriment to the corporation.

*R v Donald*

**Outline**

1. Donald was managing director and owned half the shares of Ardina Pty Ltd. The company entered into contracts with two other companies that he controlled.
2. The invoices for payment to the two companies were passed directly to Donald for payment instead of being checked by employees of Ardina Pty Ltd, as was the usual practice.
3. Some invoices were falsely made out
4. Donald did not disclose his interest in the two companies

**Decision**

1. Breach of s182
2. Companies that received payment were still gaining an advantage and it was not necessary for them to gain a profit.
3. This advantage was gained because the payments were made without the usual checking and scrutiny.

**Bribes and other Undisclosed Benefits**

S182 – Avoid conflicts of interest occurring when a director is paid a bride or secret commission in order to procure a particular course of action by the company or to influence the director in a particular way.

*Furs Ltd v Tomkies*

**Outline**

1. Furs Ltd carried on the business of processing furs for the manufacture of coats. Tomkies was its managing director and had special knowledge of tanning, dyeing and dressing operations of the business including secret formulate which was of considerable value
2. Tomkies suggested that a separate company be formed to conduct this aspect of the business
3. A purchaser was found and Tomkies negotiated a price for the business, including the value of the formulae.
4. The purchaser told Tomkies that he required his services for a new company that he proposed to form to the conduct the business.
5. Tomkies was required with the new business and Tomkies told the managing director who discharged him from Furs Ltd employment.
6. Tomkies arranged the sale of the business and he was to be employed part time and paid an additional amount to of shares and promissory notes.
7. The other directors were not told of the shares and promissory notes.

**Decision**

1. Success action for the recovery of the amount of profit Tomkies made by reason of his breach of duty
2. Conflict of interests because Tomkies failed to put the company first and the breach of duty was not dependent on the company suffering any detriment.

**Misuse of Company Funds**

Directors are under a duty to act in their companies interests with respect to the use of the companies funds.

Directors are also under a duty not to mix the companies funds with their own and a segregation of company funds from directors should always be evident.

*Paul A Davies Pty Ltd v Davies*

**Outline**

1. Company was a car dealership and a downturn in the industry meant the directors decided to enter a new venture
2. Purchased a freehold property that included a boarding house and restaurant business and was made in the directors own names.
3. Financed partyly from company funds in the form of interest-free loans to directors and the other was from a bank loan to directors
4. Company encountered financial difficulties and was placed in liquidiation.
5. Liquidator took action agains the directors arguing they had acted in breach of their fiduciary duty in that they used company funds without shareholder approval for their own private purposes and not for any purpose of the company.

**Decision**

1. Claim was upheld and the Supreme Court of NSW ordered that the directors hold the property as constructive trustees for the company
2. No defence that the money was lent to them

**Misuse of Confidential Information**

Directors are not permitted to use for their own benefit property or information entrusted to them for use on behalf of the company without appropriate disclosure and approval.

Often arises when a director leaves one company to commence work for another company.

*Facenda Chicken Ltd v Folwer*

A director or an employee after ceasing employment is not permitted to use confidential information obtained in the course of that employment for the purpose of competing with their former employer.

*Wright v Gasweld Pty Ltd*

*Forkserve Pty Ltd v Jack & Aussie Forklift*

**Outline**

1. Fidicuary duty regarding misuse of information was breached when a former employee who was a de facto director set up his own business and began soliciting his former companies customers using the companies teledex book with customers names and telephone numbers.
2. The teledex book could be classified as a customer list even though it could not be classified as confidential
3. Taking the teledex book for use in the future to compete with the employer would, but for the employers consent, have amount to a breach of duty by the employee

**Improper use of information s183 –**S183 – Supplements the fiduciary duty regarding use of confidential information and secret profits.

*Meaning of* ***“Information”***

*Rosetex Co Pty Ltd v Licata*

1. Information is referred to as that type of information that equity would restrict the director from using to his personal profit.
2. Also includes situation where an employee sets up in competition and makes improper use of information after leaving the company, even though there is no restraint of trade clause in the employees contract.

S181 and s183 overlap – *Marson Pty Ltd v Pressbank Pty Ltd* **–**

**Competing with the company -**

1. Fiduciaries are not permitted to enter into competition with the persons for whom they act.
2. Trustees cannot compete with their beneficiaries and partners cannot compete with their partnerships.
3. There is a distinction between executive and non-executive directors.

**More Duties**

S180(2) – Business Judgement rule defence against actions for breaches of the duty of care and diligence

S189 – Explains when directors are entitled to rely on information or advice; and

S190 – Deals with directors responsibility for the actions of their delegates

*Commonwealth Bank of Australia v Friedrich*

PAGE 341 – AWESOME QUOTE ON DIRECTORS RESPONSIBILITIES

**Current Standards of care, skill and diligence**

**S180(1)** – Directors and other officers owe duties of care, skill and diligence.

1. These duties are imposed by s180(1) as well as the common law tort of negligence and equitable duty of care.
2. A director or other officer of corporation must exercise their power and discharge their duties with the degree of care and diligence that a reasonable person would exercise if
   1. They were a director or officer of a corporation in the corporations circumstances; and
   2. Occupied the office held by, and had the same responsibilities within the corporation as the director or officer.
3. Common Law imposes “REASONABLE PERSON” standard and it is recognised that he precise degree of care and diligence which a reasonable person would exercise in a particular case will vary depending on the corporations circumstances as well as the office and responsibilities held by the director or officer in question.

**Directors & Officers**

S180(b) – Makes it clear that the office held by a director or officier and their responsibilities in the corporation are relevant factors in deciding the degree of care and diligence which a reasonable person would exercise

*ASIC v Rich – Page 343 –*

* + Word responsibilities is defined
  + *“The world responsibilities was intended to direct attention at the factual arrangements operating within the company and affecting the director in question – as opposed to the legal duty of care, implying specific legal duties in particular circumstances……..”*

**Non-executive Directors**

1. Not directly involved in the day-to-day management of the companies business.
2. Must rely on management led by companies managing director or CEO to properly carry out their roles as directors.

*AWA Ltd v Daniels*

1. *“While non-executive directors do not expect to be informed of the minute details of how the company is being managed, they expect to be informed of anything untoward or anything appropriate for consideration by the board…..”*

*Daniels v Anderson*

1. A large listed company which incurred large losses from foreign exchange transactions carried out by one of its middle level managers
2. Foreign exchange dealings were not adequately supervised by senior AWA executives who did not put in adequate internal controls to monitor foreign exchange activities nor did they ensure that there were adequate records kept of the numerous foreign currency dealings.
3. FX manager concealed these losses from senior excitative when he arranged unauthorised foreign currency borrowings from a number of banks.
4. AWA sued its auditors for negligence – who then cross-claimed against all AWA directors seeking contribution
5. Auditors argued that the directors had breached there duty of care

**Decision**

1. Court held that auditors were negligent but that AWA contributory negligence reduced the auditors firms liability
2. AWAs contributory negligence arose because both its senior executives and CEO were held to have been negligent and this was attributed to AWA

**STEPS REQUIRED FOR DIRECTORS TO TAKE –**

1. Must become familiar with the companies business when they join the board
2. While directors need not have equal knowledge and experience of every aspect of the companies activities, they are under a continuing obligation to make inquiries and keep themselves informed about all aspects of the companies business operations
3. Directors musts also be familiar with their companies financial position by regularly reviewing its financial statements as they will be unable to avoid liability for insolvent trading by claiming they do not know how to read financial statements (*CBA v Friedrich)*
4. Directors who are appointed because they have special skills or experience in an aspect of the companies business must also pay attention to other aspects of the companies business which might reasonably be expected to attract inquiry even if this is outside their area of expertise.
5. Directors are allowed to make business judgements and take commercial risks as long as they do so on the basis that ignorance and a failure to inquire are not protection against liability for negligence
6. Directors cannot shut their eyes to corporate misconduct and then claim they did not see the misconduct and did have a duty to look.

**Executive Directors –**

Directors must take *reasonable steps* to place themselves in a position to guide and monitor the management of a company – *Daniels v Anderson*

*Asic v Vines* – Held that expert opinon of what a reasonably competent CFO would do in the position of Vines, the CFO of GIO Insurance, was admissible evidence and relevant in deciding whether he contrived his statutory duty of care.

*ASIC v Adler* – Williams, managing director of both HIH and HIHC, breached s180(1) because he failed to make sure that the there were proper safeguards in place before HIHC lent $10 million to PEE, a company control by Adler.

*South Australia v Clark*

1. Held that Clark, the management director of the State Bank of SA, breached his duty of care to the bank
2. He arranged for the bank to acquire a subsidiary of APA Holdings for considerably more than its true value in the knowledge that APA would use the proceeds to repay a loan to Equiticorp Holdings
3. Clark did not ensure that the bank carried out the usual due diligence enquires and did not obtain an independent valuation of the subsidiary
   1. *“He was obliged to bring to bear an appropriate level of skill having regard to the responsibilities which that office entailed It was necessary for him to delegate responsibility for he operation of different functions of the bank, in the circumstances where no further oversight could be expected.*
   2. *He must unquestionably be regard as responsible for the overall control of the operations of the bank, in a day to day sense and in giving to the broader policies spelt out in the State Bank of SA.*

**Business Judgement Rule -** s180(2)

1. Provide defence against actions for breaches of the duty of care s180(1), under the common law or equity.
2. **Contained in s180(2) and four main arguments are:**
   1. **Risk-taking and entrepreneurial activities will be encourage because directors are assured by specific legislation that if they act honestly, they will not be personally liable as a result of adverse judicial review**
   2. **Better business decisions will be made as a result of the removal of uncertainty of liability under the statutory duty of care**
   3. **Shareholders interests are better served by encourage risk-taking. To make directors liable for mere errors of judgement promotes risk-averse decision making with adverse effects on the economy.**

**This assumes the following:**

1. The judgement was made in good faith and for a proper purpose
2. The was no material personal interest in the subject matter of the judgement
3. The directors and officers informed themselves about the subject matter of the judgement to the extent they reasonably believed to be appropriate
4. The judgement was rationally believed to be in the best interest of the corporation.

Business Judgement is defined to mean any decision to take or not take action in respect of a matter relevant to the business operations of the corporation s180(3).

*ASIC v Alder* –

1. Could not rely on *business judgement* defence because Adler could not satisfy s180(2)(B) required as he had a clear conflict of interest in relation to the decision to invest HIHs $10 mil in PEE.
2. Could not apply to Williams because his failure to ensure that proper safeguards were implemented was onto a business judgement of s180(3).

Designed to PROTECT DIRECTORS AND OFFICERS AGAINST LIABILITY FORE BREACHES OF THE STATUTORY DUTY OF CARE AND COMMON LAW EQUILVANET; does not operation in relation to breaches of other duties such as the s181(1) duty to act in good faith and for a proper purpose etc.

**Reliance on Others – s189**

1. Provides that a director may rely upon information or advice assuming:
   1. An employee whom the director believes on reasonable grounds to be reliable and competent in relation to the matters concerned s189(a)(i)
   2. A professional adviser or expert in relation to matters that the director believes on reasonable grounds to be within the persons professional or expert competence s189(a)(ii)
   3. Another director or officer in relation to matters within the directors or officers authority s189(a)(iii)

The reliance must be made in good faith and after making an independent assessment of the information or advice, having regard to the director’s knowledge of the corporation and the complexity of its structure and operations.

*Duke Group v Pilmer* – Court thought that directors who are informed and experienced business people are expected to be able to make sound estimates of share and company valuations

**Responsibility for Actions of Delegates –s190**

Complements s189

S190(2) – If satisfied, a director will not be responsible for the actions of a delegate if the delegate acts fraudulently, negligently or outside the scope of their delegation

**This includes:**

1. Relationship between director and delegate must be such that the director honestly holds the belief that the delegate is trustworthy, competent and someone on whom reliance can be placed. Knowledge that the delegate is dishonest or incompetent will make reliance unreasonable

**Frequency of Board Meetings and Attendance**

1. Non-executive directors are not required to give continuous attention to the affairs of their company

*Vrisakis v ASC*

View that directors are expected to attend all meetings unless exceptional circumstances, such as illness or absence from the state prevent them doing so.

*Daniels v Anderson* – No statutory requirement dealing with the frequency but directors should meet as often as is necessary in order to monitor management.

**Insider Trading**

**Personal advice** - pursuant to s766 (B) (3) and s945A (1) *“*

*Personal advice”* – s766B (3) - is advice where *“the provider of the advice has considered one or more of the persons objectives”*.

**Arranged the deal *-***  according to s766C (1) and s766 (2)

**General advice**– The meaning of *“general advice”* is defined by s761A, pursuant to s766B (4), which states that *“general advice is financial product advice that is not personal advice”*.

**Is the Person in possession of Inside Information?**

A *person* as specified in *s1043A* may be in possession of inside information, whether or not the person is an employee or has a fiduciary relationship with the company of which the information is possessed. For a person to possess inside information, the information must not be generally available pursuant to s1042C (1) (a) which states that *“information is generally available if it consists of readily observable matter”.*

If **“A”** has provided **“B”** with information which is not *“generally available”* then **“B”** can be assumed to have been provided with inside information and therefore breached s1043A because **“B”** is a person that holds *inside information* as defined in s1042A. In addition to the breach of insider trading provisions outlined in s1043A, s182 also states that an *“officer or employee of a corporation must not improperly use their position to gain advantage for themselves or someone else or cause detriment to the corporation”*. Despite the prohibition against insider trading listed in s1043A, s182 implies **“B”** has clearly used its position *“to gain advantage for them”* and *“to cause detriment to the corporation”.*

**Case: *R v Hannes* – Generally available information**

Consider the manner of the phrase **“generally available”.** Under s1042C(1)(a) & (b) it is not necessary that the information consists of a specific item of information as information will be generally available if it consists of “deductions, conclusions or inferences” drawn from readily observable matter or from the information made known to those who commonly invest in securities s1042C(2).

It should be noted that “information” has now been defined in s1042C(1) as including matters of supposition and other matters which are not sufficiently definite to warrant being made known to the public as well as matters which relate to a persons intentions or likely intentions. When read in conjunction with s1042C(2) this is an extremely wide definition of information and covers a lot of situations.

**Is there a “CHINESE WALL” in place and what does this mean?**

In accordance with ASX Market Rule 7.18.1 which states that having a *“Chinese Wall in place”,* is *“whereby information known to persons included in one part of the business of the Market Participant is not available (directly or indirectly) to those in another part of the business of the Market Participant and it is accepted that in each of the parts of the business of the Market Participant so divided decisions will be taken without reference to any interest which any other such part or any person in another other such part of the business of the Market Participant have in the matter”*   
 – s761A which defines *“participant”* as *“a person who is allowed to directly participate in the market under the markets operating rules”.* Therefore pursuant to s1043F, a corporation won’t be liable for insider trading assuming there is no communication of information between one *“part of the business”* and *“another”.*

Where a broker has a Chinese Wall in place, that will be deemed not to be in position of inside information held by another person in the brokers organisation. This provision parallels the defence found in s1043F of the Corp Act whereby a broker that manages a discretionary account upon behalf of a client, churning or the resort to an excessive number of securities transactions for the client by the broker, the broker may be regard as having acted in a prohibited manner under Market Rule 3.3.2 and Market Rule 3.4.2

This provision is aimed at monitoring the income of the broker which is gained from commissions. Thus, it can be determined if this has been breached because there has been excessive trading which on the situation and the relative circumstances.

**Has Insider Trading actually occurred?**

In developing whether a party has committed insider trading it is useful to begin at s1042B which questions the *“application of division”* of the insider trading legislation and whether it is applicable to this security.

Since securities are a *financial product* pursuant to s1042A under *“Division 3 financial Products means: (a) securities”* which are defined in *s 761A (a)* under *security* where it states that a security is *“a share in a body...or legal or equitable right or interest in a security”;* we can assume that any holdings are securities and thus financial products*.* Therefore,s1042B (a) applies since it *“applies to acts or omissions…to Division 3 financial products (regardless of where…issuer carries on a business)”.* Since **“a person whom is working within a company”** information satisfies the definition of 1042A *inside information* because it was *“not generally available”* and it would *“have a material effect on the price or value”* of the security - pursuant with 1042C’s definition of *“generally available”* and 1042D’s *“material effect”* definition – then clearly in combination with s1043A(b), **“a person whom is working within a company”** has knowledge that is defined as *inside information.*

**Example with Chinese Wall in Place – (if no Chinese Wall, B is outside party)**

Since **“a person whom is working within a company”** has told **B** about the information that has been established to be *inside information,* and as per s1043A (2) which implies **“a person whom is working within a company”** should *have “ought reasonably to (have) know(n), that the other person (****B****) would have or would likely....enter into an agreement to apply for, acquire, or dispose of relevant Division 3 financial products”* then **“a person whom is working within a company”** has breached insider trading laws.

The Merchant bank with which both A and B work will also be liable, as it has breached the both ASX Market Rule 7.18.1 and Corporation Act 2001 s1043F due to its inability to stop the passing of inside *“information known to persons included in one part of the business of the Market Participant”* being made “*available (directly or indirectly) to those in another part of the business”.*

**Does Insider Trading include FUTURES?**

A “future” must be defined as a financial product according to Corporations Act 2001 *s1042A Division 3 Financial Product*. According to s761D(1)(a) under *“Meaning of Derivative”*  it states that *“a party to the arrangement must, or may be required to provide at some future time consideration of a particular kind or kinds to someone”* and that s761D(1)(c) *“the value of arrangement, is ultimately determined, derived from or varies by reference to the value or amount of something else including an asset”* which therefore implies that futures contracts brought on the SFE are derivative products according to s761D(1) and therefore they are also within the definition of s1042A which includes *“derivatives”* as *Division 3 financial products*.

**Can Insider Trading apply to SFE?**

It has been established that **“a person”** has purchased products that are defined within *s1042A Division 3 Financial Products*, then it must again be established if *s1042B* can apply to this derivative purchase. Corporation Act 2001s1042B (a) applies since it *“applies to acts or omissions…to Division 3 financial products (regardless of where…issuer carries on a business)”.* Although **“a person”** has purchased the shares on the Sydney Futures Exchange, s1042B (a) implies that the purchase place is irrelevant in determining insider trading provisions.

Since in the previous question it was established that **“a person whom is working within a company”** information satisfies the definition of *inside information* because it was *“not generally available”* and it would have had *“a material effect on the price or value”* of the *Division 3 Financial Product* – it must be determined whether or not **B** has breached insider trading provisions by purchasing a parcel of futures as a result of this *inside information*.

**FROM HERE GOTO CHINESE WALL EXAMPLE**

**Defences to Insider Trading - Exceptions to s1043A**

**Underwriters**

Exemption for underwriters in s1043C(2) and Corps Reg 9.12.01(c)

Whereby s1043C(2) states that s1042A(2) does not apply where:

1. communication of information is solely for underwriting agreements
2. communication of information is solely for underwriting agreements

for purposes of entering into sub-underwriting agreements

**Legal Requirements**

Exceptions to s1043A are also provided for purchases of securities which are undertaken pursuant to a legal requirement – s1043D, s1043E, Corps Reg 9.12.01(d)

Including: (i) Deceased Person

(ii) Liquidator

(iii) Trustee in charge of Bankruptcy in the sale of mortgages or documents

of title

**Chinese Walls – Refer Above**

We have also seen that s1043F and s1043G provide defences to an action under s1043A where a body corporate or a partnership has in place a Chinese Wall which “could reasonably be expected to ensure that information was not communicated”, provided that the information was not communication to another person in the organisation or partnership who made a decision and provided that no advice was given in respect of a transaction by the person was in possession of the information. The Chinese Wall defence has now clearly been broadened with the introduction of the “could reasonably be expected to ensure” standard in s 1043F and 1043G.

**Trades on the Basis of their Knowledge**

**Person**

A knowledge of a natural persons own intentions in relation to a dealing in securities is also expected from the operations of s1043A by s1043H.

**Company**

A similar defence is made available for bodies corporate in s1043I.

**Trade on Behalf of another person**

A further exception is provided in s1043J for a person who enters in to a transaction upon behalf of a body corporate in relation securities of another body.

Such a person will not breach s1043A merely because he or she is aware that he first mentioned corporation proposes to enter in to or has previously entered into a transaction or agreement in relation to the securities of the other body corporate.

**Generally Available Information Defences**

**S1042C, s1043M, s1043N**

It is a defence to an action under s1043A(1) if the court is satisfied that the information came into the possession of the person as a result of being made **available** to persons whom commonly invest in securities in accordance with s1042C(1)(b)(i) and if the other persons to the transaction knew (or ought to have known) of the information prior to entering into the agreement or transaction.

**IT CASES**

***R v Evans and Doyle [1999]* [Mt Kersy]**

**Outline**

1. ASIC alleged that Evans and Doyle were guilty of insider trading in that they had breached section s1043A(1)(b) and (c) of the Corporations Law by entering into an agreement to purchase shares in Mt Kersey Mining NL.
2. At the time, Doyle worked as a dealer for the stock broker J B Were and Evans was finance director of MPI Pty Ltd, a company engaged in the business of exploring for minerals, including nickel.
3. Alleged that the inside information possessed by Doyle and Evans was that MPI Pty Ltd had discovered high grade nickel sulphide on one of its mining leases in Western Australia. Doyle knew or ought reasonably to have known that the information possessed by him was not generally available.
4. The critical issue was whether, when the two telephone conversations between Doyle and Evans occurred at 2.00 pm and 2.07 pm, there was an "agreement" to purchase shares as required by section s1043A(2)(a). The question was critical because if the agreement was held to take place when the purchase of shares occurred on the Exchange, then at this stage there was an argument that the information was generally available and therefore not confidential.

**Decision**

1. McDonald J quoted from ***Bell Group Ltd v Herald and Weekly Times Ltd*** [1985] VR buying/selling shares involves the creation of two separate contracts. The first is one of agency between the client and the broker for the sale or purchase of shares and can be referred to as an agency contract. The second contract is one for the sale and purchase of the shares, being made by the broker, in the performance of the agency contract.
2. The conclusion of McDonald J was that where a person authorises, or instructs a broker to purchase securities in a company whose securities are quoted on the Exchange and thereby enters into an agreement with the broker to purchase such securities, there is not entered into an agreement to purchase those securities within the meaning of section s1043A(2) of the Corporations Law.
3. The agreement to purchase the securities is entered into by the buying broker on behalf of the client when the agreement is concluded with the selling broker. In other words, it is only if and when a trade or agreement to purchase the securities has been achieved by the broker that the broker enters into an agreement to purchase securities causing the principal also to enter into an agreement to purchase securities.
4. Consequently, the conversations at 2.00 pm and 2.07 pm which amounted to an instruction from Evans to Doyle to purchase shares in Mt Kersey, although constituting an agency contract or agreement between these two, did not constitute an agreement for the purposes of section s1043A(2).

**Simon Hannes**

**Outline**

1. Mr Hannes was convicted on an insider trading charge that related to him (using the name 'Mark Booth') acquiring 5,000 TNT $2 call options in September 1996 through Ord Minnett Limited, when he had knowledge that TNT was likely to be the subject of a takeover bid.
2. The ASIC investigation of 'Mark Booth's' trading started within 24 hours of the announcement of a takeover by Dutch company Royal PTT Nederland NV (KPN) at $2.45 on 2 October 1996.
3. Within two days, ASIC obtained court orders freezing the $2 million profit from 'Mark Booth's' trading, and this profit was ultimately returned to the people who had sold the call options.

**Decision**

1. ASIC's investigation into the circumstances surrounding 'Mark Booth's' purchase of call options was conducted in collaboration with the Australian Federal Police and the Australian Stock Exchange.
2. Using sophisticated investigation techniques, ASIC was able to identify Mr Hannes as the person who had bought the TNT $2 call options.
3. During the trial, the Crown led forensic evidence from a handwriting expert and forensic computer expert and he was convicted of breaching s1043A of the Corporations Act.
4. The Financial Transactions Reports Act charges relate to Mr Hannes making six cash withdrawals in one day from different bank branches and then using the cash to acquire nine bank cheques, again from various bank branches.

***R v Rene Rivkin***

**Outline**

1. ASIC alleged that Mr Rivkin contravened the insider trading provisions of the Corporations Act when, on 24 April 2001, he purchased 50,000 Qantas shares.
2. The shares were purchased in the name of Rivkin Investments Pty Ltd, a company of which Mr Rivkin is the sole director.
3. The charge followed an investigation by ASIC into the circumstances surrounding trading in Qantas shares shortly before Qantas announced that it would take over the operations of Impulse Airlines.

**Decision**

1. Mr Rivkin was sentenced to nine months imprisonment, to be served by way of periodic detention, and was fined $30,000.
2. On 30 April 2003 Mr Rivkin was found guilty by jury on one count of insider trading in contravention of section 1002G(2) of the Corporations Act, following a 21-day trial in the NSW Supreme Court before Justice Whealy.

**Chairman of ASIC David Knott said:**  
“Insider trading is a serious offence that undermines the fairness and integrity of our stock market.   
  
Mr Rivkin has sought to trivialise these proceedings from the time they were first instituted. In doing so he mocks every investor who expects fair dealing and proper disclosure in share markets transactions”

**Duty to prevent insolvent trading**

• Director is under the duty to prevent the company incurring debts if there are reasonable grounds for suspecting that it is insolvent- s 588G

o Applies only to directors (s 9) at the time when co incurs relevant debt- s 588G(a)(a)

• Lift corporate veil if company insolvent- reasonable directors ought to take action if insolvent, early signs ought tell directors to stop trading

• ‘Incurring debts’

o A debt is incurred when a company ‘so acts to expose itself contractually to an obligation to make future payment of a sum of money as debt’- Hawkins v Bank of China- p 362

o Expanded definition- s 588G(1A)- table p 363

o s 588G(1)(b) requires proof that the company was insolvent when debt occurred or became insolvent because of debt

• ‘Insolvency’- inability to pay its debts as and when they fall due and payable

o Insolvency indicators- p 365

o Not temporary lack of liquidity

• Presumption of insolvency- s 588E(3)- continuing insolvency, s 588E(4)- no financial records

• Reasonable grounds for suspecting company insolvent- s 588G(1)(c)

o ASIC v Plymin- p 366

• Failure to prevent debt being incurred

o Covers inactivity and acquiescing- ASIC v Plymin- p 366

Consequences of breaching s 588G

• Compensation order whether or not in liquidation- s 588J and 588K

• Compensation payable to liquidator on behalf of unsecured creditors- s 588M

o Amount equal to loss or damage suffered

o Generally amount of unpaid debt- Powell v Fryer- p 371

• Pecuniary order under s 1317G

• Disqualification from managing corporations- s 206C

• Criminal offence (fine or imprisonment) if breach of s 588G was dishonest

Defences- s 588H

• Reasonable expectation of company insolvent- s 588H(2)

o Temporary liquidity crisis

o Tourprint International v Bott p 368- must be aware of fin position

• Delegation and reliance on others – s 588H(3)

o Competence and reliability of delegate

o Delegate must provide information

o Based on information supplied, director must expect solvency

o Reasonable reliance, questions etc.

• Absence from management for good reason- s 588H(4)

o Not turning up not good reason

o Tourprint International v Bott p 368

• All reasonable steps to prevent debts being incurred- ss 588H(5) & (6)