



Summary Notes, Entire Course

Company Law (Royal Melbourne Institute of Technology)



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Week 1 – Introduction to the Concept of Companies

1) Separate Legal Entity and The Corporate Veil p17

- Law treats a company as being a separate person from its members and those who manage its operations. The legal rules that separate the company from its participants are referred to as the “corporate veil”. Stops the law from “seeing” the participants that make up the company. Means that the law cannot look through the veil of incorporation and say that the company’s obligations, liabilities, rights or property are obligations, liabilities, rights or property of the participants.
 - Principle arises from the case of *Salomon v Salomon* where the company even though controlled by Mr Salomon was operating in its own right and was separate from its controller p18 – company separate and distinct from members and directors
 - *Lee v Lee’s Air Farming* – single director and also employee
 - *Macaura v Northern Insurance* – company separate to shareholder

2) Lifting The Corporate Veil (KNOW the Exceptions) p539

- The corporate veil can be pierced under ‘Common Law’ and ‘Statute’. This is where circumstances allow action to be taken against the directors.

- **Common Law (case law)**
 - 1) **Where the company is set up or used to perpetrate fraud**
 - *Re Darby* - where a “dummy company” was set up enabling Darby to perpetuate fraud.
 - 2) **To avoid an existing legal obligation**
 - *Gilford Motor Co Ltd v Horne* – “the principle from this case is when you set up a company to avoid a legal obligation, court says that the company is a sham arrangement”.
 - 3) **Involvement in director’s breach of duty**
 - *Green v Bestobell Industries* – Use Company to form a breach of duties, then the court will look behind the case. Lift corporate veil if company knowingly participates in a director’s breach of fiduciary duty.
 - 4) **Unfair Conduct**
 - *Ebrahimini v Westbourne* – Create a company to cause unfair conduct, courts will strike down the company and attack individual directors.
 - 5) **Company is agent of the controller**
 - *Smith, Stone and Knight Ltd v Birmingham Corporation* – the agent/subsidiary and holding company/principal are treated as one. The court treated the subsidiary as the agent of the principal. Therefore the agent and principal one

of the same. Courts looked through the subsidiary, so holding company was entitled for compensation from the city council.

6) Treat a group of companies as one

- *Equiticorp Finance v BNZ* – if subsidiary is insolvent and creditors cannot get assets from another in the group. See S588V, lift the corporate veil if subsidiaries and therefore make the holding company liable for debts of subsidiary. Note that consolidated accounts for accounting purposes treat group companies as one.
- *Briggs v James Hardie & Co Pty Ltd* (where there is a torts claim) – in a claim for torts where a person suffers an injury because of a tortious act by a company, he cannot choose which company will injure him. Whereas others entering into contract can choose who to contract with.

- **Statute Law**

Under the Corporations Act, the corporate veil can be removed by:

- ✓ **s588G Insolvent Trading** – directors have a duty to prevent a company that does insolvent trading. If it does, then the directors are personally liable.
 - ✓ **s588F Uncommercial Transactions** – company gives away assets at less than market value so directors will be liable for shortfall plus the person they gave it to.
 - ✓ **s588FP Company Officer Charges** – when company lends money to a company, and the company becomes insolvent, the charge wants to be exercised within 6 months of the loan, the charge is void against the director or officer. In other words has no security, stands as an unsecured creditor.
 - ✓ **s260A Financial Assistance to acquire own shares** – Can't acquire own shares in the company, if they do, then the directors can be personally liable.
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- 1) These are mainly dealings between the company and a director where the director attempts to get a benefit over third party creditors. The courts look through these transactions and treat the action of the company as actions of the director. Directors liable if it allows the company to trade whilst insolvent s588G – s588M
 - 2) Defeating employee's rights to entitlements – Part 5.8A
 - 3) s588FP Company officer charges loans by directors to the company secured by a charge over the company assets are treated differently to third party loans. An officer who has been granted a charge over the company assets is not within 6 months of its creation entitled to take steps to enforce the charge without court approval.
 - 4) Uncommercial transactions (in relation to insolvency) s588G – director liable for debts if company allowed to trade whilst insolvent. If already insolvent and you

allow more purchases to be made, then corporate veil can be removed – s588FB to s588FF.

Under other legislation – Income Tax Assessment Act

- 1) Directors personally liable for unpaid tax on wages and unpaid super if outstanding for at least 3 months.

3) Limited Liability - about shareholders, capacity as a shareholder and how much contribute in share capital

What it means?

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

- 1) Applies to members only and limited to the amount of any unpaid share capital or guarantees given. See s516.
- 2) Subject to s518 and s519 if the company is a company limited by shares, a member need not contribute more than the amount (if any) unpaid on the shares in respect of which the member is liable as a present or past member.

Who does it apply to?

- Shareholder liability is limited to the amount of share capital he wishes to subscribe for in the company and not liable for the debts of the company. The shareholder may be liable if he gives a guarantee to the third party for the debts of the company.

4) Legal Capacity of the Company

- Has the powers of an individual i.e. Can enter into contracts, sue people and be sued, sell goods and hold property.

See s124 capacity of company to do certain activities:

- Issue and cancel shares
- Grant options
- Distribute company property to members
- Give security over uncalled capital
- Grant circulating security interest
- Have company registered outside Australia
- Do anything that is authorised by law

Week 2 – Internal Rules for the Company

Three Statutory Contracts:

1. **s140(1)(a) – the company and each member:** States that the constitution and the RR are a contract between the company and the member. Therefore, the company can sue the member to comply with the constitution.

- *Hickman v Kent* – where Hickman had to follow the process in the rule book by going to arbitration before going to court (ONLY AS A MEMBER!)

Member can also rely on the rules in the constitution to force the company to comply. Note need to ensure that you read the constitution that it is about the rights and obligations of you as a member and not any other capacity. You may be a solicitor also providing legal advice to the company. The right to sue is not under the constitution. Member cannot force compliance of statutory contract in a non-member capacity.

- *Eley v Positive Government Security Life Assurance Co* – Mr Eley was the solicitor but when company ceased to employ him wanted to sue under s140 but failed because it doesn't relate to his rights as a member.

2. **s140(1)(b) – the company and each director and company secretary:** Only those parts of the constitution or RR that are applicable to the directors/secretary are enforceable e.g. s201G and s202A (appointment of director/secretary, remuneration of directors). Directors contract of service, if removed not within the terms of the constitution, then can sue the company but aware where director may have entered into a separate contract with the company.

- *Carrier Australasia Ltd v Hunt* – need to be appointed as a director, if process not followed for removing director, then can sue the company under this. Process of removal/appointment look at constitution, removed by shareholders.

3. **s140(1)(c) – a member and each other member:** Only those parts of the RRs or Constitution that are applicable to members as between members are enforceable as a contract.

- *Andy Kala Pty Ltd v EJ Doherty (Northcote) Pty Ltd* – Dispute between members did not affect their rights and obligations as members.

Remedies for breach of statutory contract under s140(1)(a) and (c) usually:

- Injunction (court order to not do something)
- Declaration (order made by judge)

For breach of contract under 140(1)(b)

- Damages (money – can be liquidated agreed and upfront or unliquidated)

Subject to some exceptions, shareholders may by special resolution alter the constitution. Limitations on changing the constitution under statute include:

- s136(3) and s136(4) meet requirement of rules in constitution
 - 1) s140(2) restrictions member not bound by any change to rules unless consent to in writing (so if members asked to buy more shares must consent in writing)
 - 2) s232 (alteration oppressive to member – something causing restriction, change in voting rights, change in dividends received)
 - 3) s246B (may amount to variation of class rights)
 - 4) s254A(2) (issue of preference shares)

Limitation on Changing the Internal Rules p175

The alteration involving expropriation of minority shares must be for proper purpose and fair in all circumstances – *Gambotto v WCP*.

- **Proper purpose** in order to prevent significant detriment or harm to company. E.g. Minority shareholder is competing with the company or the expropriation of the shares of the minority shareholder is necessary to ensure the company continues to comply with the law governing the company's principal business activities.
- **Procedural fairness** requires the majority shareholders to full disclose all relevant information relating to the amendment (such as the purpose of the transaction and why alternatives were not adopted). Also to obtain and disclose an independent expert's valuation of the shares to expropriated. **Substantive fairness** means that the price for the shares to expropriated must be fair.

Week 3 – The Company's Relations with Outsiders and Pre-Registration Contracts

Organic Theory p102

The company is an artificial creation and separate legal entity – separate from members and operators. It does however act through the actions of its owners and operators or senior management. Company can only function if it has people to do things on its behalf – owners and operators. They are the organs of the company – i.e. the hearts and brains. The acts of the key people will be attributed to the acts of the company. The contract is between agent and principal AND outsider and principal BUT NOT agent and outsider – the outsider cannot sue the agent.

How a Company Enters into Contract p500

1) Execution without a seal – s127 (1)

A company may execute a document without using a common seal if the document is signed by:

- a) 2 directors of the company; or
- b) a director and a company secretary of the company; or
- c) for a proprietary company that has a sole director who is also the sole company secretary – that director

2) Execution with seal - s127(2)

A company with a common seal may execute a document if the seal is fixed to the document and the fixing of the seal is witnessed by:

- a) 2 directors of the company; or
- b) a director and a company secretary of the company; or
- c) for a proprietary company that has a sole director who is also the sole company secretary – that director

3) By having any other procedure set out in the company's constitution (assuming it has one)

4) Indirectly through an agent who has authority from the company

Authority of Agent p504

- 1) Actual Authority (express or implied) s198A:** Where the principal has actually agreed that the agent can act on behalf of the principal, the agent has actual authority. Actual Authority can be either:

- **Express actual authority:** Where the principal says (verbally or in writing) that the agent can act for the principal, the agent has express actual authority. Power of directors in the Corporations Act or in Constitution says you have authority or Board of Directors by resolution give you authority. Can arise by way of oral or written statement. E.g. "The Constitution of the company says Board may make contracts up to \$100,000 but above that, shareholder approval is required" or "The board to MD managing director may make contracts up to \$10,000 in value, but above that value, Board approval is required".
- **Implied actual authority:** Indirect statements made by the principal and from principal's conduct. Implied actual authority can arise by implication from things the principal says and does. Included in 'things the principal does' are:
 - a) appointing someone to a certain position
 - b) otherwise acting to give the person authority, include through 'acquiescence'
 Although not expressly stated, it is implied by courts in the circumstances as being reasonably necessary to carry out express authority (flows naturally from express authority).
- Managing Directors – Manage the daily affairs of the company 'to do all things as fall within the usual or customary scope of that position' Hely – Hutchinson v Brayhead. What is the usual scope? Dealing with everyday matters, running the company, supervising others and being in charge – Entwells Pty Ltd v National and General Insurance Co Ltd BUT NOT selling the company's business.
- Employees – Powers depend on what has been delegated to them by the Board or MD. A junior such as shop assistant or clerk, is normally seen as having very limited implied authority compared to a senior manager within the organisation.

2) **Apparent Authority p508:** Agent appears or seems to have authority from the perspective of the outsider because the company has held out or represented the person as having the necessary authority (even if they do not have express/implied authority). Apparent authority can arise even where the principal has not in any way agreed that the agent can act on behalf of the principal. There are three requirements for an agent to have apparent authority to act for a company (see Freeman and Lockyer v Buckhurst Properties (Mangal) Ltd:

1) **There must be a holding out:** A representation must be made to the outside contracting party that the agent has authority to enter on behalf of the company into a contract. That is, the agent must be "held out"- the representation may consist of words or conduct.

➤ *Freeman and Lockyer v Buckhurst Properties (Mangal) Ltd* – where there was a holding out by the directors that K had authority to enter into contracts.

2) **The holding out must be by someone with authority:** The representation must be made by the company, or someone with actual authority to act for the

company either generally (for example, the CEO) or in relation to things which the contract relates.

- *Crabtree-Vickers Pty Ltd v Australian Direct Mail advertising and Addressing Co Ltd* – where the holding out was made by B who had no authority.

3) **Reliance by third party:** The outsider must be induced by the representation to enter into the contract. That is, the outsider must rely on the representation. E.g. Third party receiving a business card or others said third party has the authority.

- *Freeman and Lockyer v Buckhurst Properties (Mangal) Ltd* – where there was reliance by a third party.

If the above three requirements are satisfied, even if a company denies it is bound by a contract for the reason it did not authorise the contract, it may still be bound due to the existence of apparent authority.

Indoor Management Rule p517

Persons dealing with a company in good faith may assume that acts within its constitution and powers have been properly and duly performed and are not bound to inquire whether acts of internal management have been regular. Therefore, the outsider can assume that the company has followed its internal processes.

- *Royal British Bank v Turquand* – where Royal British Bank was entitled to assume that Turquand's internal process had been followed and the bank did not know or suspect there had been a failure by Turquand to follow its internal procedures.

EXCEPTION FOR WHEN THE INDOOR MANAGEMENT RULE DOESN'T APPLY:

An outsider is prevented from relying on the indoor management rule when:

- The “actual knowledge exception” applies: If the outsider actually knows that the purported agent lacked express actual authority, or that the contract was defective in some other way, then the outsider will be unable to enforce the contract on the basis of apparent authority, implied actual authority or the indoor management rule. Also, if the court find that the outsider deliberately “kept his or her eyes shut” in order not to discover the irregularity that they thought existed, the actual knowledge exception applies.
Or
- The “put on inquiry exception” applies: (a) The outsider has failed to make inquiries that would usually or customarily be made by someone in the outsider's position or (b) a reasonable person in the outsider's position would have been “put on inquiry “about a possible irregularity, and would have investigated, but the outsider has either not investigated at all or not investigated sufficiently.

- *Northside Developments Pty Ltd v Register General* – Where the company was not bound by the mortgage as Barclays Bank should have made further enquiries of the full company board suspecting irregularity but didn't.

Statutory Provisions

- s128(1) – a person is allowed to make the assumptions in s129 in relation to dealings with a company.
 - **s129 (1) – A person may assume that the company's constitution and any provisions of this Act that apply to the company as replaceable rules, have been complied with/statutory indoor management rule (refer to s129 in PowerPoint for assumptions) BUT EXCEPTION s128 (4)**
 - s129 (2) and (3) – What is customarily, note type of authority (refer to s129 in powerpoint to see authority for each person) E.g. MD can borrow money, make contracts related to the day to day operations of the company, cannot sell the business of the company, can't enter contracts that are not in the normal course of the company's business
 - s128 (3) – the assumption may be made even if an officer or agent of the company acts fraudulently, or forges a document, in connection with the dealings.
 - **s128 (4) – a person is NOT entitled to make an assumption in s129 if at the time of the dealings they knew or suspected that the assumption was incorrect.**
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- Under common law, the indoor management rule doesn't apply if fraud is present making contract invalid.
 - However, under statute law the indoor management rule does apply even if fraud exists under s128 (3) which REPLACES the common law.

Week 4 – Who Manages the Company?

Meaning of Definition of Director

s9 defines a director as a “person appointed to the position of a director or alternate director regardless of name of position”. If not validly appointed as a director the person will be a director if they act as a director or the directors are accustomed to act in accordance with the person’s instructions or wishes (defacto or shadow director).

Aspect	Private/Proprietary Companies	Public Companies
Minimum Requirements	s201A(1) - Director: - A proprietary company must have at least 1 director. That director must ordinarily reside in Australia. s204A(1) – Company Secretary: - A proprietary company is not required to have a secretary but, if it does have 1 or more secretaries, at least 1 of them must ordinarily reside in Australia.	s201A(2) - Director: - A public company must have at least directors (not counting alternate directors). At least 2 directors must ordinarily reside in Australia. - s204A(2) – Company Secretary: - A public company must have at least 1 secretary. At least 1 of them must ordinarily reside in Australia.
Who can be a Director?	s201B – Who can be a director: - s201B(1) Minimum age: Only an individual who is at least 18 may be appointed as a director of a company. - s201B(2) Disqualification: Have not been disqualified from acting as director (e.g. bankrupt 3 to 5 years, convicted of offences under s206(B)(2) – in breach of Corporations Act. - s201D(1) Consent given: Must give signed consent to act as a director before being appointed.	
Appointment	If company doesn’t have its own constitution, then they would follow s141 Table of Replaceable Rules (p720) and follow the prescribed process: - s201G/Rule #5: A company may appoint a person as a director by resolution passed in general meeting or create own rules. - s201H(1)/Rule #6 Appointment by other directors: The directors a company may appoint a person as a director. - s201H(2) Proprietary Company Confirmations by meeting within 2 months: If a person is appointed under this section as a director of a proprietary company, the company must confirm the appointment by resolution within 2 months after the appointment is made.	- s201H(3) Public Company Confirmations by next AGM: If a person appointed by other directors as a director of a public company, the company must confirm the appointment by ordinary resolution at the company’s next AGM. - s201G/Rule #5: A company may appoint a person as a director by resolution passed in general meeting or create own rules.
Removal	- For proprietary companies, directors can remove another if provided in the constitution ➤ Nibaldi v RM Fitzroy & Associates Pty Ltd - s203C: Removal by members by resolution. - Members can remove director if says in their constitution they can.	- s203E: Removal of director by other directors is NOT allowed - s203D: Removal by members at general meeting by ordinary resolution. Must give at least 2 months’ notice before meeting to remove. - s206F: ASIC power to disqualify.

Weeks 5 and 6 – Directors Duties

BEFORE YOU DO ANYTHING, NOTE THE FOLLOWING:

- 1) If the **regulator is taking action (ASIC)** against director: **Refer to Statutory Provisions/Corporations Act** so sections (public companies)
- 2) If the **company is taking action** against director: **Refer to Common Law** duties of directors (private companies)

- Chapter 10 s 180 Care, skill and diligence (Part A)
- Chapter 12 s181 (good faith and proper purpose) (Part A)
- Chapter 13 s 182 & s 183 Conflicts of interest and disclosure (Part B)
- Chapter 11 s 588G Insolvent companies (Part B)
- Chapter 14 Remedies for breach (Part B)
- Chapter 14 Defences from breach of duty (Part B)

Minimum standards of all directors:

1. be familiar with company's business and financial position;
2. monitor management;
3. inquire and seek information;
4. cannot ignore corporate misconduct

COMMON LAW - In the case of Daniels v AWA Ltd, the court said that the minimum standards are:

- A director must acquire basic understanding of the business and be familiar with the fundamentals of the business
- They must keep informed about the activities of the company
- Detailed inspection of the day to day activities is not required , only a general monitoring of the company's business affairs .Therefore attend board meetings regularly,
- Be familiar with the financial status of the company by reviewing financial statements
- Directors can make business decisions but they cannot do so in ignorance and a failure to enquire are no defence
- Cannot ignore any misconduct of the company must act
- If have a particular skill then must also pay attention to other areas of the company

CRITERIA	STATUTORY PROVISIONS (regulator takes action)	COMMON LAW (company takes action)
WHO OWES THE DUTIES?	These duties apply to directors (including de facto and shadow directors). Some provisions apply to other company officers (includes secretary) and Employees e.g. s 182 and s 183.	The duty is owed by the directors and senior executives. These people are regarded as fiduciaries.
WHO TAKES ACTION AGAINST THE DIRECTOR?	The <u>regulator</u> is taking action against director. ASIC will enforce the statute law.	The <u>company</u> is taking action against director. The company will enforce the common law against the director. The board of directors will decide whether to sue a director or not
WHAT ARE THEIR DUTIES?	<ul style="list-style-type: none"> • S 180 act with reasonable care and diligence • S 181 act in good faith in the best interests of the company and for a proper purpose • S 182 not to misuse position • S 183 not to misuse information • S 588G prevent insolvent trading - DEFENCE ON p243 s588H • S 191 disclose certain interests • S 194 disclose to other directors and vote (proprietary companies) • S 195 disclose and not able to vote (public companies) • Chapter 2E avoid related party transactions <p>- Conflict of Interest s182 and s183 but need to meet conditions s194 (private) and s195 (public 3 conditions)</p>	<p>Under the general description of fiduciary duty - act in the best interest of the members and the company. Note that there is an overlap between the statute and case law on duties.</p> <ul style="list-style-type: none"> • Duty to retain discretions • Duty to avoid conflicts of interest • Duty to act in good faith in the interests of the company • Duty to use powers for a proper purpose • Duty to act with reasonable care and diligence so DON'T say s180 just say reasonable care and diligence
WHAT ARE THE CONSEQUENCES OF BREACHING A DUTY?	<p>Civil penalty provisions enforced by ASIC</p> <ul style="list-style-type: none"> • Civil penalties see s1317E for list of sections breached by director that gives rise to civil penalties • Breach of s180, 181, 182, 183 give rise to civil penalties, action brought by ASIC, if breach then court makes a declaration of contravention • For s182/183 can ask court to: <ul style="list-style-type: none"> - Disqualify person from managing companies (reasons see ASIC v to protect shareholders, punish directors who act improperly, deter improper behaviours) - Pay penalty up to \$200k s1317G (or \$1m for a company) - Pay compensation to company for loss or damage because of breach of duty • If breach s191 (disclosure) can be fined up to \$1000 or prison for 3 months • If breach s195 (voting at meeting) fine is \$550 	<p>If breach of common law, the duty is enforced by the company.</p> <ul style="list-style-type: none"> • Company can ask for: <ul style="list-style-type: none"> - Compensation - Damages

	<ul style="list-style-type: none"> If serious, can also ask for criminal penalty under s184 - see s1311 for penalties - Imprisonment for up to 5 years - Pay fine up to \$220k 	
WHAT DEFENCES ARE AVAILABLE?	<p>Escape conflict of interest if you disclose s191</p> <ul style="list-style-type: none"> S 191 imposes duty on directors of both public and proprietary companies to disclose particular interests . It states that a director of a company who has a material personal interest in a matter that relates to the affairs of the company must give the other directors notice of the interest unless the section provides an exemption The disclosure to the other directors must: <ol style="list-style-type: none"> Be details of the nature and extent of the interest and the relation of the interest to the affairs of the company Be given at a directors meeting as soon as possible after the director becomes aware of their interest in the matter. <p>Exceptions to disclosure under s 191</p> <p>Exemptions:</p> <ul style="list-style-type: none"> If it is a proprietary company then the director does not need to give notice of the interest and the other directors are aware of the nature and extent of the interest The director has already given notice of the nature and extent of the interest to the other directors The director has given a standing notice of the nature and extent of the interest under s 192 <p>Exempt personal interest in s 191(2)</p> <p>If exempt then director does not need to disclose if it:</p> <ul style="list-style-type: none"> arises because the director is a member of the company and is held in common with the other members of the company; or arises in relation to the director's remuneration as a director of the company; <p>or</p> <ul style="list-style-type: none"> relates to a contract the company is proposing to enter into that is subject to approval by the members and will not impose any obligation on the company if it is not approved by the members; or arises merely because the director is a guarantor or has given an indemnity or security for all or part of a loan (or proposed loan) to the company; or relates to a contract that insures, or would insure, the director against liabilities the director incurs as an officer of the company (but only if the contract does not make the company or a related body corporate the insurer); or relates to any payment by the company or a related body corporate in respect of an indemnity permitted under section 199A or any contract relating to such an indemnity; <p>Relief from breach(es) of duty by:</p> <ol style="list-style-type: none"> Members at a general meeting ratifying action. But not available : <ul style="list-style-type: none"> - for breaches of statutory duties (e.g. s180, s181, s182, s183) - if it would defeat a member's personal right; - if it constitutes a fraud on the minority; - if it would prejudice the creditors. By the Court - s 1317S and s 1318 By the Company 	

Relief from breaches under s180 duty of care - Business Judgement Rule s180(2) p231:

- The courts will not review the merits of business decisions made by directors. This is called the business judgement rule.
- The belief of the director that the judgement is in the best interests of the company must be a rational one unless the belief is one that no reasonable person in their position would hold.
- Director therefore must be acting in the best interest of the company

- **Business judgment rule s180(2)**

S180 (2) A director or other officer of a corporation who makes a business judgment is taken to meet the requirements of subsection (1), and their equivalent duties at common law and in equity, in respect of the judgment if they:

- (a) make the judgment in good faith for a proper purpose; and
- (b) do not have a material personal interest in the subject matter of the judgment; and
- (c) inform themselves about the subject matter of the judgment to the extent they reasonably believe to be appropriate; and
- (d) rationaly believe that the judgment is in the best interests of the corporation.

- ASIC v Rich – held a rational belief exists if the director believes that his judgement was in the best interest of the company and that belief is supported by a reasoning process that is rational.

- The director's or officer's belief that the judgment is in the best interests of the corporation is a rational one unless the belief is one that no reasonable person in their position would hold.

Note: This subsection only operates in relation to duties under this section and their equivalent duties at common law or in equity (including the duty of care that arises under the common law principles governing liability for negligence)--it does not operate in relation to duties under any other provision of this Act or under any other laws.

(3) In this section:

"business judgment" means any decision to take or not take action in respect of a matter relevant to the business operations of the corporation.

S588H Defence to insolvent trading p243:

- Reasonable grounds to expect solvency
- Reasonable reliance on information provided by others
- Absence from management, or
- Reasonable steps to prevent incurring of debt

Week 7 – Financing of Corporations

Maintenance of Share Capital p419 – concept, who applies to and exceptions

Company law prevents a company reducing its share capital but can redeem redeemable preference shares out of profits. Key principle is a company should maintain its share capital during its life. It applies to shareholders and creditors.

- Rule: Trevor v Whitworth – Paid up capital can be lost through trading, but the assumption is that a company is trading with a certain amount of paid up capital and that the share capital has not been paid out other than in the legitimate course of business.

In order to maintain share capital:

1) There are restrictions on a company paying dividends to members. Under s254T, a company must not pay a dividend unless:

- a) the company's assets exceed its liabilities immediately before the dividend is declared and the excess is sufficient for the payment of the dividend and;
- b) the payment of the dividend is fair and reasonable to the company's shareholders as a whole and;
- c) the payment of the dividend does not materially prejudice the company's ability to pay its creditors (if company is insolvent when it pays a dividend or becomes insolvent on paying a dividend then the directors can be personally liable under s588G to the creditors)

2) There are restrictions on a company acquiring its own shares or those of its controlling entity.

3) There are restrictions on a company giving financial assistance to a person to acquire shares in the company or its holding company (see s260A and 260B - needs to be approved by members, not materially prejudicial to the interest of the company, members or creditors, allowed under another part of the corporation act)

4) Not reduce its share capital EXCEPT as permitted under

- a) Share buyback (company buys back shares from shareholders)
- b) Or other methods allowed under Chapter 2J

Maintenance of share capital happens by - Payment of Dividends, Share buy backs, Return of Capital

Rights Issue and how a Reinvestment Plan works

Rights issue – made to company's existing shareholders pro rata at the time of offers

- Renounceable (can sell the rights on market)
- Non renounceable (must exercise or they will lapse i.e. be lost)
- Dividend Reinvestment Plans (existing shareholders get shares instead of dividends – offer shares instead of paying dividends. Only take up more shares if the company was doing well)
- Bonus Issue (do not require payment)

Dividends – definition s254

3 conditions:

- Must have profit - assets less liabilities = owner's equity made up of share capital plus retained earnings
- Must be fair to all shareholders - pay equally between all shareholders
- Must not prejudice ability of company to pay creditors - so can't pay out all profits if it will prejudice company to pay creditors. If you do the directors become liable if the company becomes in