

CHAPTER 1

THE LAW

COVERED IN THIS CHAPTER

- The extent and sources of law for and about corporations
- The main statute, *Corporations Act 2001* (Cth)
- The relationship between the case law and the legislation

STATUTES AND SECTIONS TO REMEMBER

Corporations Act 2001 (Cth)

Law envisages a corporation as a separate pool of assets governed by a decision-making structure. The decision-making structure involves both a group of members and a system of strong central control in the board of directors. Membership of the group is a form of property that may be alienable, in which case it is called a 'share'.

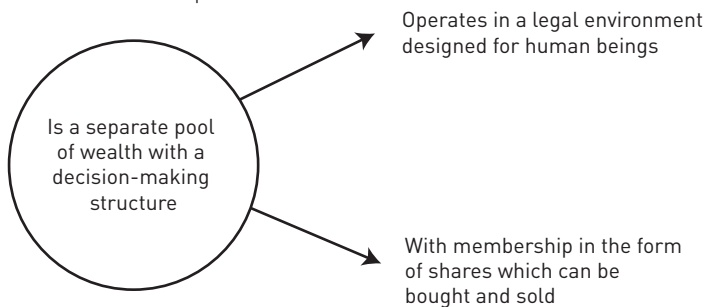
Corporations must be created by law, and law has to be made specifically to cope with corporations because law mostly assumes human beings are its subject.

Corporations enable power, in the form of control over wealth, to be accumulated and deployed—and power can be used for evil as well as good. So the way corporations work, and what they do, must be controlled.

In addition, membership is so abstract, in this form of property known as shares, that the process of buying and selling enables frauds, scams and all sorts of dishonesty to occur. Social policy aims to protect the gullible from their ignorance.

All this takes a lot of law just for corporations. That is what this book is about.

FIGURE 1.1 The corporation



THINK ABOUT IT

One of the leading thinkers in law, H L A Hart, stated that we should not consider ‘What is ...?’ questions in law (H L A Hart, ‘Definition and Theory in Jurisprudence’ (1954) 70 *Law Quarterly Review* 37, 49–57). Why might I, the author, start off this book in quite deliberate disobedience of this injunction? What are the limits and contingencies of the description set out here? Think about the uses to which it might be put. Your task of learning corporations law is clearly one such use.

Note: The description given above derives from that set out in S J Stoljar, *Groups and Entities: An Inquiry into Corporate Theory*, ANU Press, Canberra, 1973.

PARLIAMENT AND CORPORATIONS LAW

The most obvious place to look for corporations law is the *Corporations Act 2001* (Cth). This is a very long Act of the Commonwealth Parliament.

LEARNING EXERCISE

Find out just how many sections there are in the *Corporations Act 2001* (Cth).

Note: The Act is numbered to s 1471, but includes many more interpolated sections, such as the 216 sections inserted between s 601 and an existing s 602. Moreover, substantial numbers of sections are simply not there—like all those between ss 1101J and 1200A. Then there are the sections incorporated by reference, such as the transitional provisions incorporated by s 1408, and a ‘Small Business Guide’ of some 12 sections which forms part of s 111J of the Act.

It is not just that the *Corporations Act 2001* (Cth) is long; it also covers many topics, including provisions about the existence of a company, how it is governed and carries on activities, and what is to happen when it ceases to exist. These might be called the ‘substantive’ provisions.

THE SUBSTANTIVE PROVISIONS

Substantive provisions cover:

- registration of companies, their names, addresses and the various types they can be;
- how corporations contract;
- their internal rules;
- the duties, powers, appointment, disqualification and remuneration of directors and other officers;

- what a member is and members' rights and remedies;
- what shares are, what forms they can take, regulation of shares and how shares may be transferred from one person to another;
- meetings of members and directors;
- share capital and transactions affecting it;
- borrowing by companies, security for those borrowings, and what happens when there is not enough money to pay back the borrowings;
- what records a company has to keep, what reporting it has to make and how it is audited;
- various ways of changing the structure of corporations, whether capital structure, borrowing arrangements or ownership structure;
- the ways in which companies may get out of financial trouble with the help of outsiders, including ways of placing problems 'on hold' while solutions are found;
- how corporations go bankrupt through winding up in insolvency;
- how members can decide to wind up the company;
- how corporations are wound up and eventually deregistered; and
- who takes priority in getting their money if a company is being wound up.

Many other provisions in the *Corporations Act* deal with the markets that have grown up around the possibility of buying and selling memberships in corporations—memberships usually represent a 'share' in the company and are therefore of value.

THINK ABOUT IT

If we can divide up the functions of law as making things possible (engineering) and resolving disputes, which of these provisions do the former and which the latter? For example, registering a company is engineering whereas using s 1324 to stop a reduction of capital is resolving a dispute as to whether the reduction should go ahead.

PROVISIONS ABOUT SHARES AS SALEABLE PROPERTY

These provisions regulate:

- conduct in buying and selling shares;
- the process and consequences of sufficient numbers being purchased that control of the company changes; and
- the markets themselves, those that are involved with them and the services that they provide.

Finally there are the provisions which make the whole apparatus work. Some are in other Acts of various parliaments, such as the *Australian Securities and Investments Commission Act 2001* (Cth).

THE TECHNICAL PROVISIONS

Technical provisions provide detail about:

- definitions of words;
- the way regulation is to be enforced (for example, through penalties);
- the relationship between the various parliaments;
- the institutions set up for various purposes, such as general administration and regulation (the Australian Securities and Investments Commission (ASIC)), advice on law reform (the Corporations and Markets Advisory Committee (CAMAC) and the Joint Parliamentary Committee), administration and regulation of the auditing profession's involvement with corporations, and deciding disputes in certain areas such as takeovers;
- which courts are to be involved, and in what way; and
- matters to do with the transition from one set of statutes to another—all too frequent in corporations law.

LEARNING EXERCISE

Which chapters, parts or sections of the *Corporations Act 2001* (Cth) perform each of the above tasks?

Yet this is not the end of corporations law. Parliament (by indirect means) and bodies set up by parliament (more directly) provide much that can be considered 'law'. In fact law is not a category with definable boundaries. Regulation and regulatory and administrative practice are as important as the provisions of an Act. These can be found particularly in the *Corporations Regulations 2001* and in the regulatory guides, class orders and information sheets issued by ASIC, all dealing in more detail with aspects of statutory law or the exercise of discretions under it.

Nor does 'corporations law' have a definable boundary. The *Corporations Act* has substantial portions (Chapter 5C) subjecting 'managed investment schemes' to regulation, and extends some of its provisions to 'bodies that are not companies'. Indeed, the very title of the statute, the *Corporations Act*, reflects the fuzzy boundaries of 'corporations law', which provides for the registration of 'companies',

but regulates a broader range of legal entities, termed 'corporations'. And sometimes, for some purposes, even this is extended.

LEARNING EXERCISES

- 1 What is the difference between a 'corporation' and a 'company'?
- 2 What is a 'managed investment scheme'?
- 3 Can you think of a 'body that is not a company' but which is also not a human being?

Clue: Look up s 9 of the *Corporations Act 2001* (Cth).

WHAT THE ACT DOES NOT INCLUDE

Close examination of the statutory law reveals an oddity: there are some surprising fundamental omissions. The *Corporations Act* does not say some things one could reasonably expect it to say, given that it is supposed to establish and terminate all companies and regulate the wider field of all corporations.

CORE OMISSION 1

Many sections provide for 'the duties, powers, appointment, disqualification and remuneration of directors and other officers'. But there is nothing in the Act to say precisely what a director is. Section 9 says this:

director of a company or other body means:

- (a) a person who:
- (i) is appointed to the position of a director; or
 - (ii) is appointed to the position of an alternate director and is acting in that capacity;
- regardless of the name that is given to their position; and
- (b) unless the contrary intention appears, a person who is not validly appointed as a director if:
- (i) they act in the position of a director; or
 - (ii) the directors of the company or body are accustomed to act in accordance with the person's instructions or wishes.

Subparagraph (b)(ii) does not apply merely because the directors act on advice given by the person in the proper performance of functions attaching to the person's professional capacity, or the person's business relationship with the directors or the company or body.

If you read this carefully, you will see that this assumes the idea of 'director'. There is nothing in the Act to further elucidate it.

CORE OMISSION 2

'Member' is in a similar position. All the Act says is this:

231. Membership of a company

A person is a member of a company if they:

- (a) are a member of the company on its registration; or
- (b) agree to become a member of the company after its registration and their name is entered on the register of members; or
- (c) become a member of the company under s 167 (membership arising from conversion of a company from one limited by guarantee to one limited by shares).

CORE OMISSION 3

'Company' is somewhat better served by s 119:

119. Company comes into existence on registration

A company comes into existence as a body corporate at the beginning of the day on which it is registered. The company's name is the name specified in the certificate of registration.

And s 124:

124. Legal capacity and powers of a company

- (1) A company has the legal capacity and powers of an individual both in and outside this jurisdiction. A company also has all the powers of a body corporate, including the power to:
 - (a) issue and cancel shares in the company;
 - (b) issue debentures (despite any rule of law or equity to the contrary, this power includes a power to issue debentures that are irredeemable, redeemable only if a contingency, however remote, occurs, or redeemable only at the end of a period, however long);
 - (c) grant options over unissued shares in the company;
 - (d) distribute any of the company's property among the members, in kind or otherwise;
 - (e) give security by charging uncalled capital;
 - (f) grant a circulating security interest over the company's property;
 - (g) arrange for the company to be registered or recognised as a body corporate in any place outside this jurisdiction;
 - (h) do anything that it is authorised to do by any other law (including a law of a foreign country).

A company limited by guarantee does not have the power to issue shares.

Yet all this does is to equate a company to a 'body corporate' and proceed to set out the powers that are included in the suite of powers thereby conferred.

The gaps in the *Corporations Act* extend beyond the core ideas. A company's relations with the outside world might also be thought relevant for a comprehensive statute. Yet although the way a company contracts is well provided for in ss 126–30, and extended in ss 131–3 to dealing with the situation of contracts purportedly made on behalf of the company before it came into existence, there is nothing about whether, or how, a company may commit a tort or crime.

Although it is not invariably the case, many statutes in Australia state their purpose. Some chapters of the *Corporations Act* do state a specific purpose, but no general purpose is given. The Australian user is left in the dark about the whole point of the statute.

A NEW ZEALAND COMPARISON: COMPANIES ACT 1993 (NZ)

The preamble to the New Zealand *Companies Act 1993* says:

- An Act to reform the law relating to companies, and, in particular, —
- (a) to reaffirm the value of the company as a means of achieving economic and social benefits through the aggregation of capital for productive purposes, the spreading of economic risk, and the taking of business risks; and
 - (b) to provide basic and adaptable requirements for the incorporation, organisation, and operation of companies; and
 - (c) to define the relationships between companies and their directors, shareholders, and creditors; and
 - (d) to encourage efficient and responsible management of companies by allowing directors a wide discretion in matters of business judgment while at the same time providing protection for shareholders and creditors against the abuse of management power; and
 - (e) to provide straightforward and fair procedures for realising and distributing the assets of insolvent companies.

CASE LAW

There are lots of cases about corporations and corporations law. They are the product of disputes involving corporations. Wherever there has been a legal dispute, there is case law. The corollary follows: where understanding is complete and universally accepted, there is no case law. We can thus identify the various roles cases take in corporations law.

THE ROLES OF CASE LAW

Case law:

- establishes many of the important ideas, such as ‘director’ and directors’ duties, ‘body corporate’, ‘member’—indeed, the very framework upon which the statute hangs;
- fills in gaps in the legislative framework (for example, tortious and criminal liability); and
- interprets the statute.

These are conventional for any area of law. Yet the absences discussed above point to a profound and unique feature of corporations law. This is the complexity of the relationship between statute and case law. Even the preamble to the New Zealand *Companies Act 1993* illustrates this in subtle ways when it describes itself as ‘An Act to *reform* the law’, and to ‘reaffirm’, ‘provide basic and adaptable requirements’ and so forth. The assumption is that there is substantial pre-existing law, that the Act, whether the Australian or New Zealand one, is not to be taken to completely set matters out, and that many, if not most, of the relevant ideas and concepts are not established by statute. This goes beyond an assertion of the usual interpretive function of courts. It is recognition that the statute does not stand alone, that it is grounded in a case-based jurisprudence.

EXAMPLE 1: DIRECTORS’ DUTIES

Here is one example of the complex relations between the statute and case law. When courts consider directors’ duties, even though the statute provides statements of the contents of the duties in no uncertain terms, courts inevitably commence their examination with analysis of the common law. The exercise is not simply an interpretive one, but rather an acknowledgment that the way duties operate—even statutory ones—cannot be understood without consideration of their origin and development in the courts.

EXAMPLE 2: INTERNAL RULES

Section 140 provides a more extreme example of the complex relations between the statute and case law. That section deals with the enforceability of the internal rules of the company. It states that the rules ‘have effect as a contract’. If this is read on its face, the internal rules have effect as a most peculiar contract. One of the essential features of a contract is that all its terms are enforceable, yet that is not the case with the internal rules of a company. Only those that directly and personally affect a member in their capacity as member are enforceable by a member. The statute certainly does not mean what it apparently says.

Indeed, case law and the statutory law are best thought of as twin pillars, each supporting the whole field of corporations law. In this function they are sometimes in tension, although this is not surprising given their very different histories, modalities, epistemologies, locations in the field of societal governance, and techniques of governing.

THINK ABOUT IT

What are the differences in the ‘histories, modalities, epistemologies, locations in the field of societal governance, and techniques of governing’ of case law and legislation, and how might these influence the idea that the field of corporations law might be a consistent and coherent whole?

Note: Draw upon your knowledge from other law subjects to answer this. Especially consider legal methods and process subjects (under whatever name) and jurisprudence. If you have undertaken studies in politics, philosophy or sociology, you might like to consider it from their perspectives. The question might well be approached from a postmodern or governmental perspective.

ASSESSMENT PREPARATION

This chapter contains background material. You need to know what it says to fully comprehend what comes later, but it is not assessable in itself. At most, some of the ‘Think about it’ boxes might contain an essay topic.

Example essay question

Would the preamble to the *Companies Act 1993* (NZ) (set out above) be appropriate for the Australian *Corporations Act 2001* (Cth)? Consider the coverage of the New Zealand Act compared with the Australian Act. Consider also the value statements in the preamble and whether they would be appropriate for Australia.