

Corporate Law

1. Company Formations

A company is the most common type of entity used by one or more individuals to conduct business if they do not wish to trade in their personal capacities. Relevant factors in deciding whether to incorporate a company include limited liability, perpetual succession, financing and taxation matters. A company is for many purposes treated as a separate legal 'person' and certain laws, particularly the *Corporations Act 2001* (Cth), apply to it.

There are two types of company under Australian law: 'proprietary companies' and 'public companies'. The essential difference between them is that a proprietary company can have no more than 50 non-employee shareholders and must not engage in any fundraising activity that would require the lodgment of a prospectus. A public company on the other hand may have more than 50 non-employee shareholders and may engage in fundraising activities which necessitate the lodgment of a prospectus. Only a public company can be listed on the stock exchange (ASX).

A shareholder is a person or legal entity who or which has invested a certain amount of capital in a company and, in return, owns a proportionate part of that company in the form of shares. The shares may, but need not necessarily give the shareholder the right to receive dividends from the company and certain rights regarding the direction of the company.

Proprietary companies have certain privileges which are not available to public companies. Most significantly, proprietary companies have fewer financial disclosure requirements than public companies. They are not required to hold an Annual General Meeting (AGM) and can make or pass shareholder resolutions without a general meeting. The compliance costs and cost of formalities are also less for proprietary companies.

Proprietary companies can be divided into two sub-categories: companies which are 'limited by shares' and companies which are 'unlimited with share capital'. When a company is 'limited by shares', shareholders can only be held liable for the unpaid cost (if any) of the shares in the company they hold. If the company is in debt or goes into liquidation, shareholders are not personally liable for those debts. When a company is 'unlimited with share capital', the shareholders have unlimited liability for debts that the company may accrue. Therefore this form of company structure mostly applies to very low financial risk corporations and is rarely used. One benefit of such a structure, however, is that there are no strict requirements on the movement of share capital in this type of entity.

Proprietary companies can be further divided into small and large proprietary companies. If a proprietary company is a 'small proprietary company' then it also enjoys further exemptions. A company is a 'small proprietary company' if it satisfies any two of the three following conditions:

1. the consolidated gross operating revenue for the financial year of the company and the entities the company controls is less than \$25 million;
2. the value of the consolidated gross assets at the end of the financial year of the company and the entities it controls is less than \$12.5 million; and/or
3. the company and the entities it controls have fewer than 50 employees at the end of the financial year.

If a proprietary company is a 'large proprietary company' then the company must prepare and lodge annually a director's report and audited accounts with the Australian Securities and Investments Commission.

2. **Company Obligations and Remedies**

The legal obligations of a company depend on the size and type of the company.

1. Financial Reports, Audits and Formalities

All companies have legal obligations regarding financial statements and audits. Every company must keep written financial records which correctly record and explain its transactions and financial position such that they would enable true and fair financial statements of the company's activities to be prepared and audited.

Large proprietary companies (and in some circumstances small proprietary companies) must prepare a financial report and director's report each financial year.

Proprietary companies may be incorporated with a single shareholder and trade with a single director and are not required by law to hold an Annual General Meeting (AGM). A proprietary company may pass shareholder resolutions without holding a General Meeting but all shareholders must all sign an agreement or other document in favour of the resolution. Proprietary companies are not affected by legislation regulating a director's participation in decisions of the board of directors where that director may have a material personal interest in the decision. Furthermore, proprietary companies are exempt from legislation regulating related party transactions.

2. Obligations under Corporate Constitutions

A significant set of legal obligations for proprietary companies are those created by the company's constitution. The constitution (previously called the "memorandum and articles of association") is a document which defines the structure and operation of a company. A company can adopt an independent constitution and/or be governed by certain procedural requirements defined in the relevant legislation (*Corporations Act 2001* (Cth)). The governing legislation contains a number of both mandatory and optional requirements for proprietary companies.

Corporate constitutions create obligations for the company to be directed in certain ways, including but not limited to procedures such as timing and content of AGMs, voting, inspection of company books, the transfer of shares and so forth. Constitutions may also define procedures for members or shareholders to convene meetings of the company.

3. Remedies

The Australian Securities and Investments Commission (ASIC) may initiate investigation, order the production of certain documents, fine the company or take further actions against directors if certain laws or obligations are breached.

A breach of the constitution will, in certain circumstances, invalidate motions passed by a director's meeting or an AGM. A breach of mandatory legal requirements may again be investigated by ASIC.

3. **Directors' and Shareholders' Agreements**

A 'directors' agreement' is an agreement made between two or more directors, independent of the company's constitution or contracts in which the company is involved. Problems may arise in such agreements when they contradict the constitution of the company or the company's contracts.

A 'shareholders' agreement' is an agreement made between two or more shareholders, independent of the company's constitution or contracts in which the company is involved. Often such agreements are made by people who seek the protection of a limited liability corporate structure while maintaining the flexibility of a partnership. The agreements usually concern the exercise of shareholders rights including buy-out arrangements in the event of voluntary and involuntary departures.

Frequently Asked Questions about Corporations

1. **How many directors must a company have?**

A proprietary company needs only one director.

2. **Does a director have to be an Australian resident?**

At least one director of a proprietary company must be ordinarily resident in Australia. If the company is a sole director company then that director must be ordinarily resident in Australia. All other directors can be resident anywhere in the world.

3. **What does ordinarily resident in Australia mean?**

There is no concrete definition on "ordinarily resident in Australia" but it has been interpreted to mean Australia being the settled and usual place of abode or where a person regularly or customarily lives. There has to be some element of permanence, to be contrasted with a place where a person only stays casually or intermittently. A person registered in Australia for tax purposes will generally be regarded as ordinarily resident in Australia.

4. **Who can be a director?**

Any person who is at least 18 years of age may be appointed a director.

5. How many shareholders must a company have?

A proprietary company needs only one shareholder.

6. What is the minimum amount of share capital required?

There is no minimum amount of share capital for the incorporation of a company.

7. What is the maximum number of shareholders for a company?

For a proprietary limited company, the maximum is 50 non-employee shareholders.

8. Are directors liable for a company's debts?

Limited liability will generally prevent a director from being liable for the company's liabilities. However, a breach of directors' duties, usually regarding insolvent trading, may make the directors personally liable in some circumstances.

9. To what extent are the shareholders liable for the company's debts?

For a company 'limited by shares', such as a proprietary limited company, a shareholder is only liable for the unpaid cost (if any) of the shares in the company he or she holds.

10. Is a company required to have a common seal?

A company is not required to have a common seal. A company can execute documents and make contracts without a common seal.

11. Is a company required to have a constitution?

No, it is not. A company has all the legal powers of a natural person. Nevertheless, most companies, even sole directors and sole shareholders companies, commonly have a written constitution.

12. Who "owns" the company?

The shareholders own the capital of the company but the directors control the company.

13. How are shareholders' interests maintained where the directors control the company?

Directors' duties cover several aspects of the relationship between the best interests of the company (and ultimately the shareholders) and the actions of the directors. There are also a limited number of circumstances under which shareholders can bring personal actions against directors.

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