

# Company law course wrap up



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MGMT3046 Company Law: Course Wrap Up November 2012 We have come to the end of formal instruction in Company Law, so it is useful at this point to review the main learnings from the course. This will be somewhat long!

Unit1 Salomon v Salomon and the corporate veil. This is a foundational case in company law which enunciated the principle of the separateness of company and its members (shareholders and officers). The principle makes it quite clear that the separation of the company from its members will always hold; it is only in exceptional cases that the corporate veil will be lifted, such as in instances of fraud or other illegality.

This means that a company may contract in its own name and, similarly, be held liable for breaches committed in its name. As mentioned before, shareholders and officers of the company will not usually be held liable for acts committed by the company. This leads directly to the concept of limited liability. Since a company is a separate legal entity, it follows that its members will not be liable for its debts. As a distinct legal entity, a company's assets belong to it and not its members; its liabilities belong to it and are not the responsibility of the members.

In the event of the company becoming insolvent or bankrupt, a shareholder's loss would only be limited to the amount of unpaid shares he has outstanding in the company. In this way, a shareholder is afforded limited liability. Conversely, unlimited liability companies impose unlimited liability on its members. Ultra Vires. Ultra vires describes acts undertaken beyond (ultra) the legal powers (vires) of those who have purported to undertake them.

The three main applications of ultra vires were: o whether the company acted outside its capacity; o whether the company's agents acted in excess of authority; and o whether the company's act was contrary to statutory provisions. This proved to create great difficulties for creditors as they might provide goods and services to companies which, when they refused or were unable to honour payment, were protected by the fact that contracts were deemed null and void and therefore unenforceable.

Creditors had no recourse in the face of this issue. See *Ashbury Railway Carriage & Iron Co Ltd v Riche*. Ultra vires has since been abolished by statute such that, even though companies and its members may not be authorised to act in a particular way or to make certain decisions, they may still be liable for such unauthorised acts as against third parties. This concept will return again in other units. Unit 2 Lifting the Corporate Veil.

The corporate veil does not provide blanket protection to the members and officers of a company. It will only if they have acted carefully, honestly and in good faith. In cases of illegality and negligence, the veil may be lifted to expose the offending member to liability. Both statute and common law provide for the lifting of the corporate veil in such instances. This Session discussed the statutory exceptions to limited liability which include: 1  
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reduction of number of members (it is to be noted that while a company may be operated with only one director under UK statute for up to six months, the same does not hold for Trinidad and Tobago); fraudulent and wrongful trading (these apply only during the winding up process [to be dealt with in further detail in Unit 8]; wrongful trading may be inferred from “reckless  
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disregard” as found in s 447(1)(b) and (c)); disqualified directors (a director may be disqualified either during the course of normal operations of the company or during the winding up process); abuse of company names (this usually involves the transfer of company assets at an undervalue to the new company); and other named offences relating to documentation. While the veil of incorporation usually affords protection to a company’s members and officers, the Court will lift it in cases of statutory breaches where strict liability attaches to those found responsible for the breach.

The Responsible Corporate Officer Doctrine, which holds the decision-making officer liable, operates very similarly in other legislation but is held to be separate from lifting the veil. At common law, the court will be prepared to lift the corporate veil under very limited circumstances. While there are no clearly defined categories, the court will lift the veil where individuals are concerned in instances of using the corporation as an agent (based on the degree of control exercised by the shareholders over the operations of the company) or where there is fraud or impropriety. In the case of corporations as shareholders, the court will lift the veil in cases where it can find an implied agency relationship and a group of companies acting as a single entity.

It is generally held that the court will lift the veil in parent-subsidary relationships where the evidence shows that the subsidiary is but an agent of the parent (based on the degree of control exercised by the latter over the former); statutory or contractual provisions dictate that it should be lifted; or the subsidiary is established as a sham. A company will be deemed to be acting fraudulently where it is established to avoid a court order or other

legal obligations; this usually applies where the shareholders are individuals. In such cases, the court will lift the veil to expose the company's members to liability. Unit 3 Directors of a Company. A director's behaviour is governed largely by the Companies Act, specifically by section 99. A director's responsibilities and liabilities are very clear and simple.

He must exercise the powers of the company; direct the management of the company (s 60); declare any personal interests (s 93); act honestly and in good faith; and exercise care, diligence and skill a reasonable person would exercise under similar conditions. Any breach of these requirements will lead to personal liability on the director's part. The company may choose to indemnify a director for any liabilities incurred where he acted honestly and in good faith and in the best interest of the company (s 101). Particular attention should be paid to the words used in section 99 and their meaning.

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Directors of a Company. A director's behaviour is also governed by common law which reflects, in large part, section 99 of the Companies Act.

They owe a fiduciary duty to the company to act in the best interest of the company, lawfully, honestly and in good faith, otherwise, they will be in breach of their fiduciary duties owed to the company. *Pardy v Dobbin* is an excellent case on point. Shareholders are able to indemnify a director's acts or decisions if they so choose where there is disclosure by the director of his interest. Apart from the duties owed, a director may be held personally liable in tort or for criminal activity, especially in cases of fraud or negligence, and will not have the protection of the corporate veil. It is important to note that where the tortious conduct of a director is motivated by self-interest or

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personal benefit, then the director may be liable (*Blacklaws v Morrow*, 2000 ABCA 175 (CanLII), paragraph 137).

Personal liability will only attach, therefore, where it can be proven that the acts of the director are separate from the interest of the company or where such acts have been expressly directed by him. Fraud is proved when it is shown that a fraudulent misrepresentation has been made (i) knowingly, or (ii) without belief in its truth, or (iii) recklessly, carelessly whether it be true or false. A director will be held liable where any of these is proved. With respect to criminal liability, a director will usually be held criminally and personally liable where he acted in fraud on the employer, for his own benefit, or contrary to instructions.

In other cases of criminal liability, the company will be held to be vicariously liable, together with the officer in question. Under the directing mind or identification principle, a corporation may be held vicariously liable for the criminal acts of its "directing mind". In mens rea [criminal intent] offences, if the Court finds the director to be a vital organ of the company and virtually its directing mind in the sphere of duty assigned him so that his actions and intent are deemed the action and intent of the company itself, the company can be held criminally liable even where the criminal act was performed not wholly for the benefit of the company. He must, however, have been acting within the scope of the area of the work assigned to him.

In the case of fraud, where the benefit accrues only to the director and is not intended to be for the benefit of the company, the corporate entity may be able to escape liability. Other Officers of a Company. Their behaviour, too, is

governed by section 99 of the Companies Act. Unit 5 Shareholders. A shareholder is a member of a company, usually someone who has invested in the company and is considered an owner or part-owner. At law, the shareholder is not the incorporated entity; they are distinct entities, where the company is deemed a separate, legal person with rights, privileges and liabilities, 3 MGMT3046 Company Law: Course Wrap Up November 2012 in like manner as a shareholder. Their rights, privileges, liabilities, immunities and procedures for holding meetings are all covered by the Companies Act.

In addition to the Companies Act, shareholders' relationship with each other and the company are further governed by the terms of the shareholders' agreement, which may place restrictions on their behaviour. It should be noted that there are certain fundamental changes that may only be effected by the shareholders. Unit 6 Status of the Minority Shareholder. The majority rules. This is enshrined in law, both common and statutory law. This makes it very difficult for minority shareholders to protect the interest of the company. This principle has its roots in the foundational case of *Foss v Harbottle* [1843] 67 ER 189 which addresses the heavily circumscribed status of the minority shareholder.

Section 37(c) of the Interpretation Act further compounds this issue as it also reinforces this principle. In addition to the majority rules principle, another important issue that arose is the proper plaintiff rule. The court held that if the majority is committing wrongs against the company, it is the company itself that should take action to protect itself. Nevertheless, the law has taken into consideration the underprivileged position of the minority shareholder and allows him to take actions as exceptions to the rule in *Foss*

v Harbottle. As the company is an inanimate entity, it cannot take action on its own, hence the relaxation of the proper plaintiff rule to allow the minority to act on its behalf.

Obviously, the majority would be the entity to allow or disallow any such action and they will not permit the minority to take action against them. The minority shareholder(s) will have a right of action against the majority shareholder(s) in specific situations. He may be allowed to take derivative action – an action brought by a shareholder (or director) of a company in the name and on behalf of that company – in very peculiar circumstances. This means that any benefit accrues to the company only and not to the benefit of the shareholder. There are certain acts that a majority may not legally undertake and for which the minority may initiate such action.

The minority has a common law right of derivative action where the majority attempts to:

- o Confirm an act which is ultra vires or illegal;
- o Confirm an act which constitutes a fraud against the minority where the wrongdoers are themselves in control of the company;
- o Confirm an act which can only be validly done or sanctioned, not by a simple majority but by some special majority; otherwise, a company could de facto do by simple majority something which required a special majority; or
- o Affect qualified minority rights.

o Where his personal rights are affected, he may take action in his own name. Any benefit here accrues directly to the shareholder. The minority shareholder also has rights under the Companies Act to protect the interests of the company against the will of the majority. As in the common law, the act also allows for derivative action pursuant to section 240. The procedure in 4 MGMT3046 Company Law: Course Wrap Up November 2012 s

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240 must be followed prior to making a claim based on any of the four common law rights of derivative action mentioned.

With respect to personal rights of action, minority shareholders may dissent to shareholder resolutions seeking to make fundamental changes to the corporate entity (s 227) or may seek to restrain oppressive behaviour on the part of the majority that is unfairly prejudicial to or unfairly dismissive of the interests of shareholders or other members or officers of the company (s 242). In this way, the minority shareholder is offered the right under law to protect his own interest or the interest of the company. Unit 7 Insider Trading. This relates to trading in public companies. An insider is someone who breaches a fiduciary duty owed to his employer to act honestly and uses unpublished, price-sensitive information to trade in securities or communicates such information to someone else who trades. The information he has will be considered material if it will help an investor determine whether or not to purchase or sell shares.

Where an insider uses such information for his personal benefit to avoid a loss or make a profit, he will be in breach of the Companies Act, the Securities Industry Act and common law principles relating to: o Access to confidential information; o Breach of fiduciary duty or other relationship of trust; o Material confidential information; and o Using material confidential information for one's benefit. Unit 8 Winding Up and Dissolution. Winding up is the process of liquidating a company and its assets and then distributing the proceeds while dissolution is the cessation of the company. The most important issue here is trading while insolvent. This is regulated by s 447(1) of the Companies Act.

This section raises the issue of fraudulent trading, where it is discovered during the liquidation process that the company continued carrying on business, despite knowing or being unconcerned that it would have been unable to honour its debts and liabilities. Liability under this section is usually triggered when the court is satisfied that a person has not taken every possible step with a view to minimising the potential loss to the company's creditors as he ought to have taken. Several important words and phrases are used in this section: intent to defraud; reckless disregard; debts and liabilities; knowingly; and personally responsible. The Central Bank case provides an excellent exposition into s 447(1) and the meaning of these terms. The use of such words and phrases make it clear that anyone guilty of this offence must have purposely or carelessly undertaken these acts despite knowledge or care of the company's inability to cover the debts and liabilities incurred by it. Any person so guilty will be held personally responsible without any limitation of liability. It should be noted that this is not restricted to directors and officers; anyone, such as an accountant who may have audited the accounts and been aware of the dire financial situation, for example, who was knowingly involved would be held liable as well. It also applies to past officers and directors. 5

MGMT3046 Company Law: Course Wrap Up Unit 9 November 2012 Corporate Governance. Corporate governance has assumed great prominence within the last twenty years. There are many definitions, but they all revolve around good management practices which encompass accountability, transparency and honest. Several financial scandals, resulting from a lack of these traits, led to the promulgation of codes of conduct for companies. These codes

focused on remuneration for directors, the role of the non-executive director, reporting functions of the board, and the role of auditors and audit committees. An ultimate combined code was created that encompassed the main points of each individual code.

While none of these codes have the force of law, they provide a moral barometer specifically for public companies to engage in good management practices. Private entities are welcomed and encouraged to follow these guidelines as well. The wide range of stakeholders just might ensure that these non-binding codes are adhered to, as companies, public and private, are required to act in the best interest of the company and society at large. The threat of damage to the company's reputation may also assist in this regard. Of course, where companies fail to do so, they will be subject statutory and common law sanctions, even where the codes lack the ability to penalise.

Section 99 of the Companies Act, in particular, and common law fiduciary duties apply here. Unit 10 Partnerships. What is a partnership? They are unincorporated entities, known as firms, comprising any combination of two or more individuals, or one or more individuals and one or more corporations, or two or more corporations (s 4, Companies Act). The relation which subsists between persons carrying on a business in common with a view of profit (s 3(1), Partnership Act) How is a Partnership different to a Company? Unincorporated entities Based on the law of agency Partners bear equal benefits and liabilities Formal establishment not necessary Less statutory responsibilities What does not necessarily constitute a Partnership? joint ownership; sharing of gross returns [Cox v Coulson – no agency]; and <https://assignbuster.com/company-law-course-wrap-up/>

sharing of profits [Stekel v Ellice – employment contract vs partnership agreement]. Creation of a Partnership Persons who invest monies to open a company prior to its incorporation or to commence a partnership will not be deemed to be partners during the period before the company or partnership comes into existence. This was the case in Spicer Ltd v Mansell. 6

MGMT3046 Company Law: Course Wrap Up November 2012 Partnership at Will Partnerships that are not subject to any formal agreement. No fixed duration. May be terminated with immediate effect by any partner at any time. Refers to continued partnerships as well.

Relations of Partners to Persons Dealing with Them (Higgins v Beaucham [1914] 3 KB 1192; Mann v D’Arcy and Others [1968] 1 WLR 893) Partners are deemed to be agents of each other and, therefore, have the authority to take unilateral decisions which will bind the firm, save in cases of fraud or other illegality. Joint liability Liability may continue post retirement An agreement may discharge a retiree from liabilities Liability and Holding Out (Tower Cabinet Co Ltd v Ingram [1949] 2 KB 397) Anyone who represents or allows himself to be represented as a partner of a firm will be held liable where the firm’s creditors seek payment. Liability of New and Retired Partners (Bilborough v Holmes (1877) 5 Ch D 255; Rolfe v Flower (1865-67) LR 1 PC 27) Partners’ liability begins upon admission to the firm and ceases upon demission under ordinary circumstances. An agreement may discharge him from any liabilities.

A former partner may still be liable for any breaches even after he has left where no such agreement is made. Relations of Partners to One Another (In re Barber (1869-70) L. R. 5 Ch. App. 687) The terms of a partnership

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agreement may only be varied by the consent of all partners. Partnership Property (Davis v Davis [1894] 1 Ch 393) Partnership property is property that is utilised for the purposes of the partnership. Title to partnership assets may be in the names of all the partners, as in a co-ownership arrangement, or in the names of some partners or one partner. Rights and Duties among Partners (Tann v Herrington [2009] EWHC 445 (Ch)) 26. a) share equally in benefits and liabilities; (b) indemnify every partner for payments made and personal liabilities incurred by him in the ordinary and proper conduct of the business of the firm; or (ii) in or about anything necessarily done for the preservation of the business or property of the firm; (g) no person may be introduced as a partner without the consent of all existing partners; (h)...no change may be made in the nature of the partnership business without the consent of all existing partners; Any liability to a third party is recoverable against the partners jointly and severally. 7 MGMT3046 Company Law:

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Tann v Herrington – duty of care, duty to act in good faith, skill Where this is disproved and some element of culpability is also proved, the individual partner only may be held liable. Expulsion of a Partner (In Re A Solicitors' Arbitration [1962] 1 All ER 772) The concept of majority rule is ordinarily alien to partnerships, especially where expulsion of a partner is the issue. How does expulsion work? All partners must have unanimously agreed at the creation of the partnership to expel the offending partner. Expulsion does not hold where there are only two partners; the partnership will be automatically dissolved should one leave. This power of expulsion is one that must be exercised bona fide and in the general interests of the partnership.

Dissolution of Partnerships Ordinarily, a partnership is automatically dissolved: at the expiration of any fixed term, the completion of an undertaking which was the reason for the creation of the partnership, or the death or bankruptcy of a partner. An application may be made to the court for a decree of dissolution in the case of: insanity, incapacity, or misconduct of a partner; where the business is running at a loss; or where it is just and equitable for the partnership to be dissolved. Problems associated with dissolution Division and distribution of the firm's assets and liability; Continuation of partnership: Pathirana v Pathirana General vs technical dissolution: Green v Harnum 8