

Law of Associations

Examiners Comments September 2013

Question 1

This question was concerned with section 180 of the *Corporations Act*, section 295 (4) of the *Act* (dealing with Directors declarations attaching to Financial Statements) and with the legal principles discussed in *ASIC v Healey* [2011] FCA 717; *ASIC v MacDonald* (2009) 71 ACSR 368; *ASIC v Rich* (2009) 236 FLR 1; *Vines v ASIC* (2007) 62 ACSR 1; *ASIC v Adler* (2002) 41 ACSR 72.

Students were required to identify the legal principles discussed in the cases above **and** to apply them to the facts. Simply reciting the facts in *Healey's* case was not sufficient to answer the question.

The principles required to be identified included that each director armed with the information available to him or her, was expected to focus on matters brought before them and to seriously consider such matters and take appropriate action. This task demanded of directors critical and detailed attention and not just “going through the motions”. Directors were required to take reasonable steps to place themselves in a position to guide and monitor the company’s affairs. Directors cannot substitute reliance upon the advice of management for their own attention and examination of an important matter that falls specifically within the Board’s responsibilities as with reporting obligations. The *Act* places upon the Board and each director a specific task of approving the Financial Statements. Consequently, each member of the Board was charged with the responsibility of attending to and focusing on a company’s financial statements and under those circumstances could not delegate or abdicate that responsibility to others. The objective duty of competence required directors to have the ability to read and understand Financial Statements.

Although many students identified at least some of the legal principles (albeit not all of the relevant major principles and only in a superficial way) there were very few students who adequately applied the legal principles to the facts. The major facts that needed to be identified and applied to the legal principles included that there was substantial evidence that the Directors were given, during the period leading up to the 2012 Financial Statements, financial information which revealed that the Company had \$800 million in short term current liabilities and that the Directors gave the declaration under section 295 (4) of the *Act* without reading the 2012 Financial Statements in any detail, preferring to rely on the persons who participated in the Company’s Financial and Audit Structure.

Some students correctly referred to section 180(2) of the *Act*, namely the business judgement rule. Only very few students, however, gave a full explanation why section 180 (2) could not assist the Directors in the question namely that the discharge by the Directors of their “oversight duties” such as their duty to monitor the company’s affairs and policies and to maintain familiarity with the company’s financial position, is not protected by the business judgement rule in section 180(2) because the discharge or failure to discharge those duties does not involve any business judgement: *ASIC v Rich*.

Question 2

This question required consideration of sections 127-130 of the *Corporations Act* dealing with the indoor management rule. Many students unnecessarily referred at length to the common law indoor management rule rather than focusing on the *Corporations Act* which is the applicable law.

Students were required to apply *Story v Advance Bank of Australia Limited* (1993) 31 NSWLR 722 to section 128 (1) of the *Act*. The principles in *Story's* case provided that a person is entitled to make the assumptions in section 129 of the *Act* in relation to "dealings" with a company and that the section applied to "dealings" that were entered into with purported company agents who lacked actual authority and extended to forged instruments. Students should then have applied the principles in *Story's* case with the facts in the question, namely that Mr Love was Managing Director and had de facto control of the Company.

Students were then required to specifically recognise sections 129(1) (2) (5) and (6) as containing the major assumptions that the Bank could make having regard to the facts in the question. With regard to section 129(2) reference should have been made to the fact that although Mrs Love was not recorded as Secretary of the Company with ASIC she was recorded as a Director and should have applied that fact to the principles expressed in *Brick and Pipe Industries v Occidental Life Nominees Pty Limited* (1990) 3 ACSR 649. With regard to section 129(5) and (6) reference should have been made to section 127 and how that section applied to the way that the mortgage document was executed. On the question of the execution of the Mortgage, reference should have been made to the fact in the question that the Mortgage "appeared" to have been executed by the Company and how that fact applied to the principles in *Soyfer v Earlmaze Pty Limited* [2000] NSWSC 1068.

Students were required to recognise that a central issue in the question was whether the Bank could make the assumptions in section 129 notwithstanding that Mr Love had forged the signature of Mrs Love. This required an analysis of sections 128(3) and 128(4) of the *Act*. Students were required to apply the facts to the major cases such as *Sunburst Properties Pty Limited v Agwater Pty Limited* [2005] SASC 335 and *Errichetti Holdings Pty Limited v Western Plaza Hotel Corp* (2006) 201 FLR 192. Students were required to recognise that the test of whether the Bank could rely on the forged Mortgage by making the assumptions in section 129 was dependent on whether the Bank had "actual knowledge" or "actual suspicion" of Mr Love's fraud and that the test was not "being put on enquiry".

Question 3

This question required an analysis of sections 236 and 237 (1) (2) and (3) of the *Corporations Act* dealing with derivative actions.

Most students, at least in part, referred to *Swanson v R A Pratt Properties Pty Limited* (2002) 42 ACSR 313 and the test set out by Justice Palmer to satisfy the requirements in section 237(2) of the *Act*. However many students failed to consider adequately the entire test set out

by Justice Palmer or to adequately apply the facts to the test set out by Justice Palmer. Answers should have included the following principles properly applied to the facts:

- (a) “good faith” was required to be proved by the applicant by evidence that the applicant honestly believed that a good cause of action exists and has a good prospect of success and that the applicant was not seeking to bring a derivative action for a collateral purpose;
- (b) the requirement of “good faith” will be relatively easy for the applicant to demonstrate to the Court’s satisfaction where the application is made by a current shareholder of the company who has more than a token shareholding and the derivative action seeks recovery of property so that the value of the applicant’s shares would be increased: *Swanson’s* case;
- (c) “best interests of the company” has been interpreted to mean the company’s separate and independent welfare: *Charlton v Baher* (2003) 47 ACSR 31; *Chahwen v Euphoric Pty Limited* (2008) 65 ACSR 661; see also Justice Austin’s judgment in *Fiduciary Limited v Morning Star Research Pty Limited* [2004] NSWSC 664; that this enquiry will include taking into account the circumstances of the company and its ability to undertake litigation and the ability of the defendant to pay a judgment;
- (d) that section 237(3) provides the circumstances in which there is a rebuttable presumption that granting leave would not be in the “best interests of the company”; and
- (e) the Court must be satisfied that there is a serious question to be tried, namely that the applicant has demonstrated the legal or equitable rights to be determined at trial and that this enquiry is the same kind of inquiry on an interlocutory injunction.

Question 4

This question concerned partnership. The question needed to be answered in two parts. Failure to answer each part meant that only half marks could apply.

The first part of the question required a consideration of whether a partnership existed between Jim, Melone and Steven pursuant to section 1 **and** section 2(3)(d) of the *Partnership Act*. Many students simply recited all or parts of section 2 without fully understanding the relevance of each part of section 2 of the *Act*.

The first part of the question also required reference to cases such as *Canny Gabriel Castle Advertising v Volume Sales (Finances) Pty Limited* (1994) 131 CLR 321; *United Dominions Corporation v Brian* (1985) 157 CLR 1; *Lang v James Morrison and Co Limited* (1911) 13 CLR 1; *Ex Parte Delhasse In re Megevant* (1877- 1878) 7 Ch D 511. These cases provide the common law approach to the indicia of partnership.

The second part of the question required a consideration of whether Steven was liable to the Supply Centre for the purchase by Jim of machinery and equipment. This meant that students had to assume (if they had not found a partnership between Jim, Melone and Steven pursuant to section 1 and 2 of the *Partnership Act*) that Jim, Melone and Steven were in partnership.

Having found a partnership (or assumed a partnership) the second part of the question required an analysis and application of section 5 of the *Partnership Act*. This required a consideration of the elements of section 5 of the *Partnership Act* and to have regard to cases such as *Polkinghorne v Holland* (1934) 51 CLR 143; *Mercantile Credit v Garrod* [1962] All ER 1103; *Construction Engineering (Aust) Pty Limited v Hexyl Pty Limited* (1985) 155 CLR 541.

Question 5

This question required an analysis of sections 232 and 233 of the *Corporations Act*.

The question required reference to the general test of oppression in section 232 by reference to such cases as *Wayde v NSW Rugby League Limited* (1985) 180 CLR 459 and *Nassar v Innovative Precasters Group Pty Limited* (2009) 71 ACSR 343 and how those general principles applied to the facts in the question. The question then required an analysis of the particular facts in the question by reference to cases dealing with reducing shareholder's interest in a company. Those cases included *JD Hannes & Ors v MJH Pty Limited & Ors* (1992) 7 ACSR 8 and more particularly *Re Dalkeith Investments Pty Limited* (1985) 9 ACLR 247.

The answer then required reference to section 233 of the Act dealing with remedies for a breach of section 232 and in particular the compulsory purchase of the minority shares in order to bring an end to the oppression: *Campbell's case*.

Question 6

This question related to the insolvent trading provisions in sections 588G and 588H of the *Corporations Act*.

The question required an application of 588G by reference to cases dealing with "insolvency" "debt" and "reasonable suspicion" such as *Southern Cross Investment Pty Limited (in liq) v Deputy Commissioner of Taxation* (2001) 39 ACSR 305 and *ASIC v Plymin* (2003) 21 ACLC 700.

The question then required an application of sections 588H(2)-(4) of the Act by reference to cases such as *Hall v Poolman* (2007) 65 ACSR 123; *Manpac Industries Pty Limited v Ceccattini* (2002) ACLC 1,204 and *Metal Manufacturing Limited v Lewis* (1988) 6 ACLC 725

