

CHAPTER 6

PROPRIETARY COMPANY REGISTRATION

An application to register a proprietary company should include a copy of its constitution

6.1 *The Company Law Review Act 1988*, which was enacted by Parliament in June 1998, redrafted provisions of the Corporations Law dealing with the registration of companies.

6.2 Public companies, as before, are required to lodge a copy of their constitution on registration and any modifications of their constitution with the ASIC.¹ While there is no similar requirement for proprietary companies, the Corporations Law grants:

- The power to the ASIC to direct a company to lodge a consolidated copy of its constitution;² and
- The right of a member to request the company to send them a copy of the company's constitution.³

6.3 This was the second matter which has been the subject of complaint and/or concern expressed to the Government by the business community. The PJSC heard considerable evidence on this matter and has set out below the views put to it.

Arguments in favour of a requirement that proprietary companies lodge a constitution

Ascertaining whether company documents are validly executed

6.4 Mr John Wilkin of Corrs Chambers Westgarth argued that the requirement to lodge constitutions with the ASIC will assist those who deal with companies to determine whether the company is legally bound as a result of those dealings. According to the Small Business Guide Paragraphs 1.7 and 1.8 in Part 1.5 of Schedule 1 of the Law, the powers of directors, including the power to bind the company contractually, are subject to the company's constitution. The lodging of the constitution with the ASIC will enable those dealing with companies to conduct appropriate searches to ascertain who the

1 Section 136.

2 Section 138.

3 Section 139.

directors are, the extent of their powers, and how the company is to execute documents and contracts.

6.5 It was claimed that this is all the more important given that legal cases have increased the uncertainty about when a company will be bound by a document executed by it. The cases cited by Mr Wilkin are: *Brick & Pipe Industries v Occidental Life Nominees* [1992]2 VR 279; *Northside Developments v Registrar General* (1990)170 CLR 146; *Storey v Advance Bank* (1993)31 NSW LR 722; and *Bank of New Zealand v Fiberni* (1993)14 ACSR 736.

6.6 Mr Wilkin pointed out some of the deficiencies of the present provisions of the Law:

- Under section 128(1) a person is entitled to make assumptions only "in relation to dealings with a company". This must be the "company", not an unauthorised director or officer;⁴
- If the Articles of Association are not complied with a contractual document may be invalid – *Brick & Pipe Industries v Occidental Life Nominees* (1990) 3 ACSR 649;⁵
- Even if a person can assume under section 129 that a document has been duly executed by a company, it may be invalidated by searches the bank must perform to determine the authority of the signatories – *Bank of New Zealand v Fiberni* (1993) 14 ACSR 736;⁶
- Under the new section 128(4), a person cannot make an assumption if he "suspected that the assumption was incorrect". This is more onerous than the previous test where either 'actual knowledge' was required or a person's relationship with the company was such that he "ought to have known" that the matter was incorrect;⁷
- Unless the company's constitution is accessible, it is difficult to see how a person could not 'suspect' that 'the person' was not entitled to assume the document was correctly executed in accordance with the constitution.⁸

6.7 Mr Wilkin recommended that companies should lodge their constitutions with the ASIC so persons dealing with them can ascertain how they are required to execute documents. Further, to safeguard against outdated

4 Mr John Wilkin, Submission 21, pp 4-5.

5 Mr John Wilkin, Submission 21, p 5.

6 Mr John Wilkin, Submission 21, p 5.

7 Mr John Wilkin, Submission 21, p 5.

8 Mr John Wilkin, Submission 21, p 6. See also Mr John Wilkin, Committee Hansard, 16 June 1999, p 42.

records at the ASIC, a company should be bound by documents executed in accordance with section 74 of the Property Law Act (Victoria) because the company should appoint directors for whom it is liable.⁹

Need for certainty in dealing with companies

6.8 The Accounting Bodies supported the proposal for proprietary companies to lodge a constitution pointing to an inconsistency in the Law that requires large proprietary companies to submit financial reports but does not require a public record of their rules of conduct. It was argued that fundamental information about a company should be placed on the public record and accessible to all interested parties.¹⁰ The Accounting Bodies stated that there was “a need for certainty among persons who deal with a company about the internal rules that apply to it.”¹¹

6.9 Similarly, the Australian Law Reform Commission (ALRC) noted that “something as fundamental as a body’s constituting instrument should be filed.”¹² However, the ALRC advised that formal lodgements should be kept to absolute essentials to minimise cost and administrative burdens on corporations and the ASIC.¹³

Costs of maintaining a database

6.10 Arnold Bloch Leibler gave qualified support for the requirement submitting that any amendments to a company’s constitution should also be lodged with the ASIC. Further, the ASIC would have to consider the costs of establishing the database that would be available for public inspection and the costs of ensuring that all constitutions are up to date. To achieve the latter, all proprietary companies would have to re-lodge their constitutions.¹⁴

6.11 The Corporate Network Ltd advised that the provision of a repository service by the ASIC would not be a serious cost issue:

9 Mr John Wilkin, Submission 21, pp 6-7.

10 Joint Submission by the Australian Society of Certified Practising Accountants and the Institute of Chartered Accountants in Australia, Submission 73, p 3.

11 Joint Submission by the Australian Society of Certified Practising Accountants and the Institute of Chartered Accountants in Australia, Submission 73, p 3. Several other organisations expressed similar views to that of the Accounting Bodies. See Chartered Institute of Company Secretaries in Australia Ltd, Victoria Branch, Submission 25, p 2; Association of Mining and Exploration Companies Inc, Submission 45, p 2; the Australian Listed Companies Association Inc, Submission 66, p 2; and M.A.I. Services Pty Ltd, Submission 80, p 5.

12 Australian Law Reform Commission, Submission 10, p 4.

13 Australian Law Reform Commission, Submission 10, p 4.

14 Arnold Bloch Leibler, Submission 23, pp 6-7.

The State CAC's filed such documents for many years with a lower staff to incorporations ratio than the ASIC appears to enjoy. Further, the ASIC, since ceasing to file these documents, has never reduced its filing fees. Effectively, the "service" is no longer provided, but is still being paid for.¹⁵

Prevention of problems caused by the purported issue of shares in the absence of a constitution

6.12 The Corporate Network Ltd supported the proposed lodgement of constitutions on the grounds that it will help prevent situations where companies purport to issue particular classes of shares but lack the constitutional capacity to do so. Corporate Network Ltd reported that many parties are completing application for registration forms indicating that particular classes of shares have been taken up by consenting members, but have failed to set out the rights for such classes in a constitution or failed to adopt a constitution. The PJSC was advised that about 50% of all new companies registered since 1 July 1998 are flawed in this way.¹⁶

6.13 Uncertainty has prevailed as to how these cases should be resolved. The ASIC's legal opinion to the Corporate Network Ltd is that the company is registered but the shares never existed and could not have been issued. Application could be made to the Supreme Court for rectification, deregistration or to be wound-up. Recent judicial trends have seen applications for rectification fail where proper procedure has not been followed. Further, as deregistration relies on the consent of shareholders and such companies do not have any valid shareholders, such an application would also fail. In the view of the Corporate Network Ltd, the lodgement of constitutions with the ASIC will avoid these problems and protect the public.¹⁷

Arguments against the requirement that proprietary companies should lodge a copy of their constitution

6.14 The West Australia Joint Legislative Review Committee of the Australian Society of Certified Practising Accountants, The Institute of Chartered Accountants and the Chartered Institute of Company Secretaries opposed the requirement for lodgment of constitutions on a number of grounds, including that it would place an unnecessary burden on both the ASIC and companies themselves. The Review Committee noted the following:

15 Corporate Network Ltd, Submission 39, p 1.

16 Corporate Network Ltd, Submission 39, p 2.

17 Corporate Network Ltd, Submission 39, p 2. The Corporate Network Ltd also noted that it is not uncommon for companies to lose their constitution and there are some situations where constitutions are required urgently.

- There are over 1 million proprietary companies;
- Despite the changes introduced in the *First Corporate Law Simplification Act 1995*, as at 30 June 1998 many companies still have a 'Table A' constitution. In time, those companies will amend their constitutions in line with the simplification provisions. If those companies are required to lodge a copy of their constitution with the ASIC, the management of this amount of documentation will be costly to the ASIC;
- The public has full protection under sections 128-130 of the Law and therefore do not need to know the contents of a constitution to secure their interests when transacting with the company;
- Section 139 of the Company Law Review Act could be extended so that outsiders (not only members) can obtain a copy from the company for a prescribed fee;
- If the ASIC were to pre-vet the constitution then the requirement might offer protection. However, the ASIC has no such role and lodgement of a constitution might give members a false expectation that the document has received the approval of the regulator.¹⁸

6.15 At its hearing on 16 August 1999, the PJSC was advised that the Review Committee had changed its position. The Review Committee now supported the inclusion of proprietary company constitutions, adding that most companies “hopefully, will take up the replaceable rules.”¹⁹

Contrary to the objective of the replaceable rules

6.16 The Australian Institute of Company Directors (AICD) and Mr Peter Jooste QC were of the view that the requirement would run counter to the ‘replaceable rules’ mechanism. Mr Jooste stated:

The object of the “replaceable rule” scheme ... is to save on costs and to progress efficiency and uniformity in regard to companies that do not opt to adopt different internal regulations. In my view, requiring a copy to be lodged would detract from such efficiency and cost saving.²⁰

6.17 The AICD contended that the requirement was inconsistent with the aim of simplicity, efficiency and streamlining of the process of setting up a

18 West Australia Joint Legislative Review Committee of the Australian Society of CPA, the Institute of Chartered Accountants and the Chartered Institute of Company Secretaries, Submission 18, p 3.

19 Mr Laurie Factor, Committee Hansard, 16 August 1999, p 122.

20 Mr Peter Jooste QC, Submission 48, p 2.

company. Parties dealing with a proprietary company can request a copy of its constitution.²¹

6.18 Other grounds for opposing the proposed requirement were that:

- The requirement would cause unnecessary expense and traders can make their own inquiries;²²
- It is an unnecessary burden and cost for business, especially small business;²³
- A supplier can demand a copy of the company constitution as part of an application for supplier credit.²⁴

Proposed amendments to the Replaceable Rules

6.19 As part of its consideration of the question whether an application to register a proprietary company should include a copy of its constitution, the PJSC examined a related proposed amendment. Part 2A.2 of the Corporations Law deals with registration of companies and section 117 therein with the application for registration.²⁵ Section 117(2)(k) requires a company limited by shares or an unlimited company applying for registration to state certain basic information about the shares which each member has agreed to take up.

6.20 The proposed amendment, section 117(2)(ka), would require further information to be stated in the application in relation to such shares. The additional information that would be required under section 117(2)(ka) includes:

- i. a summary of the rights and conditions attaching to the shares agreed to be taken up;
- ii. the total number of persons who have consented to be members and the information referred to in subparagraphs (k)(i) and k(ii);
- iii. a statement that, if a constitution has not been adopted, the Replaceable Rules will apply and that they create a contract between the members the terms of which may alter if the Replaceable Rules change after the company is registered.

21 Australian Institute of Company Directors, Submission 47, p 4.

22 Mr JA Sutton, Submission 57, p 2.

23 Ernst & Young, Submission 38, p 2 and Ms Jan Wade MP, Victorian Minister for Fair Trading, Submission 74, p ii.

24 Ms Jan Wade MP, Victorian Minister for Fair Trading, Submission 74, p ii.

25 The proposed amendment to section 117 of the Law was referred to the Committee by the Senate during debate on the Company Law Review Bill 1997. See Hansard, *Senate*, 24 June 1998, P3484.

Duplication in requiring a statement under item (iii)

6.21 Mr Laurie Factor, Senior Lecturer at the School of Business Law, Curtin University, noted that item (iii) of the proposed amendment, section 117(2)(ka), which requires a statement of the contractual relationship and the application of the replaceable rules, was unnecessary:

This is a statement for those registering a company that they acknowledge the contractual relationship, and that they understand that the constitution will change from time to time and that they are bound by the new terms...I just thought that was unnecessary duplication.²⁶

Investor protection

6.22 The Corporate Network Ltd submitted that the rationale for the proposed amendment was to provide an element of consumer self-protection to counter the problem of persons not knowing with whom they are dealing and/or not knowing the true rights attached to shares they have been induced to apply for:

The intention was that it should not be possible for a person to discover that another person they had no knowledge of was a co-shareholder in their company, or that shares they applied for had different rights to what they expected.²⁷

6.23 In addition, the PJSC was advised that there are other investor protection issues involved in the consideration of the proposed amendment. The replaceable rules confer different rights to shares in a proprietary company than to shares in a public company. In particular, replaceable rules shares in a proprietary company carry discretionary rights to dividends whereas replaceable rules in a public company carry equal rights to dividends. The relevant provision reads:

254W (2) Shares in proprietary companies

Subject to the terms on which shares in a proprietary company are on issue, the directors may pay dividends as they see fit.

6.24 The Corporate Network Ltd advised that this causes particular problems where a proprietary company changes status to a public company (or vice versa). The rights attaching to shares automatically change. Further, the rights attaching to shares also change where a sole director/member company

26 Mr Laurie Factor, Committee Hansard, 16 August 1999, p 122.

27 Corporate Network Ltd, Submission 39, p 3.

without a constitution issues a share to another person. In those circumstances, a notice of conversion of shares would be necessary.²⁸

6.25 The Corporate Network Ltd submitted that the conversion creates potential capital gains tax and notification problems. In addition, the dividends rights provision can be used by a sole director to “starve a spouse of income in a family/marital separation”. The latter situation can arise where a typical family business, operating as a partnership and giving both spouses an equal right to income, is converted to a company and the company adopts the replaceable rules and only one spouse/member is a director. Income will be distributed at the discretion of the sole director. Where a marital breakdown occurs, the party in the position of sole director will be able to “starve” the estranged partner of income during the property settlement negotiations.²⁹

6.26 The Corporate Network Limited submitted that the warning to consumers should be made explicit. It recommended a substitute provision in place of the proposed amendment and that this provision should appear on the application for registration.

Conclusions

6.27 Registration confers certain rights and entitlements on a company in conducting its business. The PJSC believes that information about a company as fundamental as its internal rules, powers and shareholding should be available to parties dealing with the company in the commercial environment. As Mr Wilkin noted, the uncertainty about documents executed by a company can affect the efficient conduct of its business.

6.28 The PJSC notes that the *Company Law Review Act 1998* has reduced significantly the process of company registration and simplified the way a company conducts its affairs. The changes to the Corporations Law have benefited all companies, notably newly registered companies. However, if the statistic that at least 50% of all new companies have purportedly issued shares of a particular class or classes without having adopted a constitution is correct, then this presents an unsatisfactory risk for the company and its members.

6.29 The PJSC concludes that a proprietary company should file a copy of its constitution on registration with the ASIC. However, a proprietary company on filing its constitution may elect to adopt the replaceable rules in place of a constitution. Any subsequent modifications to its constitution should also be filed with the ASIC. The PJSC also concludes that proprietary companies should re-lodge their constitutions and that the ASIC maintain a database for this purpose. The ASIC should also retain its emergency power under section

28 Corporate Network Ltd, Submission 39, p 3.

29 Corporate Network Ltd, Submission 39, p 4.

138 to direct a company to lodge a consolidated copy of its constitution with the ASIC.

6.30 The PJSC has considered the proposed amendment inserting section 117(2)(ka) and is of the view that the dividend rights provision in the replaceable rules has brought about an unintended consequence where a partnership is converted to a proprietary company. As the PJSC noted earlier, the replaceable rules confer different rights to shares in a proprietary company than to shares in a public company. Where a partnership is converted to a proprietary company the dividend distribution is at the discretion of the directors of a proprietary company and, as a consequence, a joint shareholder of the former partnership may not receive an equal distribution of the dividends. To the extent that persons may not be aware of the rights attached to shares in a proprietary company, in particular the change in the distribution of dividends, the PJSC concludes that the proposed amendment should be adopted. However, as Mr Laurie Factor advised the PJSC, item (iii) of the proposed amendment is superfluous.

Recommendation

6.31 The PJSC recommends that the Corporations Law should provide for:

- i. a proprietary company to lodge a copy of its constitution on registration with the ASIC; and
- ii. proposed amendment section 117(2)(ka), apart from item (iii).