LAW REFORM

The Close Corporations Bill 1988 (Cth.)

The subject matter of this report has come about as the result of the recommendations of the Company and Securities Law Review Committee's *Report to the Ministerial Council on Forms of Legal Organisation for Small Business Enterprises* (1985). The Close Corporations Bill 1988 (Cth.) ('the Bill') is part of one of the most ambitious legislative enterprises in the history of the Federal Parliament, which is intended to cover the entire field of companies and securities law in this country. The package consists of three main Bills and thirteen ancillary Bills which deal with fees and levies. The three main Bills are:

the Corporations Bill 1988,

the Australian Securities Commission Bill 1988, and

the Close Corporations Bill 1988.

It should be acknowledged that there is intense speculation in legal, business and media circles about the constitutional and political viability of the Bills. At the very least there will be some considerable amendments to the package, although the positive response of the Senate Joint Select Committee ('the Edwards Committee') signals good political fortune for the Bill. Some readers may speculate on the appropriateness of a review of the legislation at this early stage. It is considered that the Close Corporations Bill will attract the least criticism of all the reforms in the package and, if enacted, will remain substantially in its current form. This is despite its position as the most radical and reformist Bill in the package: with only a few, but significant exceptions the other Bills adopt the provisions of the existing national scheme legislation. The Close Corporations Bill provides for an entirely new corporate form, which is tailored for the needs of small businesses.

The term 'close corporation' appears to be borrowed from US legal parlance, where it can more properly be described as a legal colloqualism than a term of art. It is a corporate form developed by practitioners and adopted by some legislatures to suit closely-held businesses where there is a limit on the number of members and restrictions on the trading of its shares. The term is used in contradistinction to 'public issue corporation' or 'publicly held corporation', but despite this they are not separate corporate entities. As can be seen from the foregoing, the US 'close corporation' corresponds to the UK 'private company' or the Australian 'proprietary company', which are in essence adaptations of the 'public company' corporate form. The proposed Australian close corporation will be a new and separate kind of corporation, with many of the aspects of an incorporated association as well as those of a partnership. As opposed to the management structure of a company, the ownership and management of a close corporation will be integrated — there will be no need for a board of directors. The result is a much simpler and less expensive corporate vehicle which should

have much appeal to small businesses, as they will no longer have to satisfy the same burdensome management, financial and reporting requirements that the existing scheme applies to huge multinational firms and small businesses alike. It goes much further than the relaxation of regulation provided for by the exempt proprietary company.

The Bill is a sizeable piece of legislation, comprising some 170 sections which are grouped into eighteen parts. It is not possible to examine each provision in detail; the following is an overview of the Bill based on the classification of its provisions into its various parts.

Part 1 — Preliminary

As well as the usual preliminaries, this part provides for the proposed Act to bind the Crown in respect of the insolvency provisions. As for the proposed companies legislation, the proposed Australian Securities Commission ('the Commission') will administer the proposed Act.

Part 2 — Registration

A close corporation may be formed by no more than ten members, who must all be natural persons. The members sign a founding statement which is lodged with the Commission for registration. The statement has only a few requirements, principally the corporation's name, address of its premises, amount of share capital, and details of the subscribers and their intended shareholdings. As can be seen this is far less detail than is required by the memorandum and articles of association of a company, which are replaced by the non-registrable 'association agreement'.

The Commission then issues a certificate of incorporation and a corporation registration number. The certificate is conclusive evidence of incorporation, and from its date of issue the corporation has the characteristics of a traditional body corporate, except that it may not act as trustee under an express trust. Provision is made for the conversion of a company into a close corporation.

The only other principal document that must be lodged is an activities statement, whose function is to ensure that the corporation is within the constitutional power of the Commonwealth by establishing that it is a trading corporation.

Part 3 — Names

This part mirrors closely the existing requirements as to names in the national scheme legislation, expect that where the founding statement does not specify a name, the Commission may include its incorporation registration number as its name. At the end of its name a close corporation must have the words 'Close Corporation' or the abbreviation 'C.C.'.

Part 4 — Legal Capacity and Powers

These are much the same as those of traditional companies with the important exceptions of the power to act as trustee, to act as holding company and to make

offers or invitations to the public. If a member misleads someone to believe that the close corporation is a trustee under an express trust, then that member, and not the close corporation will be liable for any debt, liability or obligation incurred as a result. While there is a prohibition against becoming a holding company, a close corporation may hold shares in another body corporate. The doctrine of constructive notice will be abolished in respect of close corporations, except as regards registrable charges.

Part 5 — Membership

The proposed Act provides for the usual general rules as to membership. The number of members may range from one to ten, who must all be natural persons, and a majority of whom must be Australian residents. The share capital is to be divided into one class of fully paid shares with the same rights attached to each share.

As there is no separation of management and ownership in a close corporation a person who would be disqualified from acting as a director of a company is disqualified from being a member of a close corporation without a successful application to the Court.

Part 6 — Title to and Transfer of Securities

Shares in a close corporation may not be transferred without the consent of the other members, which may not be withheld without just cause. The members may agree to drop this requirement either generally, in particular circumstances or under particular conditions. The procedural requirements for transfers and registrations are those in the Corporations Bill, which are much the same as those which presently apply to the companies. All members must agree to the allotment of shares by the corporation.

Part 7 — Internal Administration

The management of the corporation is to be performed by the members, who may enter into a non-registrable written agreement known as the association agreement, which then binds the members. Unless otherwise provided for in the association agreement, every member is entitled to participate in the management of the close corporation. Provisions are made in the proposed Act for the non-remuneration of members acting in the affairs of the company; for an indemnity similar to the usual directors' indemnity; for loans by members to the corporation and the resolution of differences by majority vote, except in the case of change of the corporation's principal function. These provisions may be varied by the members.

There is no requirement for formal meetings of members of a close corporation, but they may be called in the usual way.

The members are placed under some obligations which are borrowed from partnership law:

- a duty to give true accounts and full information of all matters affecting the corporation;

- accountability of members for benefits derived from activities concerning the corporation without the consent of the other members;
- a prohibition against competing with the corporation; and
- liability for loss resulting from negligence, fraud or improper use of information aquired by virtue of being a member.

The oppression remedies in the Corporations Bill are also available to members of a close corporation.

Part 8 — Accounts and Returns

This is an area in which major reforms are made by the Bill in the interests of simplicity and reduced expense. A close corporation is required to:

(a) keep such accounting records as correctly explain the transactions of the corporation and its financial position; and
(b) keep its accounting records in such a manner as will enable the preparation from time to time of true and fair accounts.

Failure to do the above may result in the Court's lifting the corporate veil and attaching personal liability to the members. Annual returns need not be lodged, all that is required is an annual certificate of compliance stating that annual accounting and annual activities statement requirements have been met, the latter of which is to ensure the continuity of the constitutional requirement that the corporation be a trading corporation.

Part 9 — Transactions on Behalf of Close Corporations

Again concepts are borrowed from the law of partnership. Each member is an agent of the corporation for the purposes of any business of the corporation, and any act done by a member in the course of carrying on the usual way of a business of the corporation is binding on the corporation, unless the members had agreed that the member was not authorised to act on behalf of the corporation in the matter concerned, and the other party knew of this, or if the other party did not know, or did not believe, that the member was a member. There are also provisions for the ratification of pre-incorporation contracts.

Part 10 — Provisions Relating to Shares

Unlike other corporate forms, a close corporation will be able to purchase its own shares in certain circumstances. A 'decisive number' (as defined in the definition section) of members must consent to the acquisition and sign a declaration of solvency of the corporation six months before the acquisition. The declaration of solvency must be based on reasonable grounds, otherwise personal liability for the debts of the corporation may attach to the members.

The corporation must then cause to be published a notice that the corporation proposes to buy the shares after a specified period of time has elapsed, and a creditor of the corporation may object and obtain an injunction to restrain the acquisition.

Shares that are so acquired may not be re-issued and must be cancelled. If

the buy-back renders the corporation insolvent, personal liability may attach to the members.

There are the usual rules against a corporation financing dealings in its own shares. A 'decisive number' of members may agree in writing to authorise the giving of finance for an acquisition of the corporation's own shares, in which case the acquisition is not prohibited.

Part 11 — Charges, Part 12 — Arrangements and Reconstructions, Part 13 — Receivers and Managers, Part 14 — Official Management

In all these matters the provisions of the Corporations Bill, which apply to conventional companies, apply in the case of close corporations.

Part 15 — Liability of Members for the Corporation's Debts and Liabilities

The usual rule against personal liability applies. However a court may lift the corporate veil in the following situations:

- the number of members exceeds 10;
- proper accounting records are not kept;
- the corporation becomes a holding company;
- the corporation becomes unable to pay its debts as and when they fall due and the members fail to act to remedy the situation or to have the corporation wound up; or
- the corporation acquires its own shares after the members have made an improper declaration of solvency.

Part 16 — Winding Up

The relevant provisions of the Corporations Bill apply, but there are some additional provisions relating to the priority of claims. The most significant difference is the ranking of non-member creditors before member creditors, and the Commission receives priority before any other creditors. Liquidators may apply to have their costs paid from the Liquidators' Recovery Trust Fund.

Part 17 — Liquidators' Recovery Trust Fund

This fund is to be established by the Commission and close corporations are required to make contributions on registration. The Commission may require additional contributions.

Part 18 — General

This Part deals with powers of courts, legal proceedings, offences and civil liability for contraventions, and certain miscellaneous items. These are essentially procedural matters, being more mechanical than substantial they do not warrant close attention here. The courts empowered to adjudicate disputes are the Federal Court, the State Supreme Courts and the Territory Supreme Courts, in so far as the Constitution permits in the last case.

A number of corporate offences relating to insolvency and to fraudulent conduct are created.

There are special provisions for the payment of dividends by a close corporation. The complex common law rules are done away with and replaced with the following pre-requisites:

- the total value of assets of the corporation exceeds, and would after payment of the dividend continue to exceed, the total liabilities of the corporation; and
- there are reasonable grounds to believe that the corporation is able, and would continue to be able to pay its debts as and when they become due.

Conclusion

It is considered that the Close Corporations Bill 1988, if enacted, will make a welcome and useful addition to Australian Company Law. A number of doubts have been raised by commentators as to its popularity as a corporate form in practice. The somewhat extensive exposure of members to personal liability will deter some small business entrepeneurs, as will the limitations on the share structure, capital raising, membership and relationships with other companies, that is to say the limitations of the expansion of a close corporation. Unlike an exempt proprietary company, it cannot become a public company as it grows. The close corporation legislation in some other jurisdictions has not achieved its desired success. Nonetheless, as the Edwards Committee report concludes, the benefits may only become apparent after the legislation has been in operation for some time.

Surrogate Motherhood. Artificial Conception Discussion Paper 3, August 1988, New South Wales Law Reform Commission.

Surrogate Motherhood. Artificial Conception Report 3, December 1988, New South Wales Law Reform Commission.

The final report of the New South Wales Law Reform Commission on Surrogate Motherhood has resulted from a long process of public consultation and evaluation that began with a reference made in 1983 from the Attorney-General on a range of issues concerning artificial conception.

The paramount consideration in considering such arrangements, according to the Commission, should be the welfare of the child, and this should prevail over the interests of the adults involved in a surrogate motherhood arrangement.

The commission recommends that while 'the practice of surrogate motherhood should be discouraged by all practicable legal and social means', it would be inappropriate to totally prohibit surrogacy arrangements by statute.

The recommendations of the Commission are very similar to the provisions enacted recently in Victoria in the Infertility (Medical Procedures) Act, 1984.

Thus:

— Surrogacy arrangements should be void and unenforceable at law.
— All forms of commercial surrogacy should be prohibited, and it should be a criminal offence to receive, offer or solicit any reward for participation in, or facilitation of, a surrogacy arrangement.
— Advertising in relation to surrogacy should be prohibited.

As in Victoria, so-called 'altruistic' surrogacy, or private surrogacy arrangements for no reward are not prohibited. The Report states: 'We find it unacceptable to impose sanctions on those who participate in the practice privately'. However, where in Victoria, unpaid intermediaries are permitted to arrange or assist in carrying out such a surrogacy arrangement, under the New South Wales Law Reform Commission's recommendations, such a person would be subject to criminal sanctions.

The Commission recommends that a doctor, psychologist, social worker or relatives or friends of the immediate parties to the surrogacy 'should be subject to the criminal penalties if they give active assistance to the parties in giving effect to their arrangements'. This would make it very difficult for a private surrogacy arrangement to take place.

One member of the Commission, Ms Helen Gamble, presents a strong minority view on this issue, arguing that:

> members of the medical and health care professions will be subject to a lot of pressure from some of their patients to assist in both the planning and performance of surrogacy arrangements. So long as they do not hold themselves out as brokers or procurers of surrogacy, they should not be subject to criminal penalties.

The Commission was in agreement, however, that it should be a criminal offence to draft or assist in the drafting of a surrogacy agreement.

Developing Human Rights Jurisprudence: the Domestic Application of International Human Rights Norms. Report of a Judicial Colloquium in Bangalore, February 1988, Human Rights Unit, Commonwealth Secretariat.

In February 1988, ten senior jurists from different Commonwealth countries, including Justice Michael Kirby from Australia, and one judge from the United States, gathered in Bangalore, India, to discuss the question of the application of the international law of human rights in the domestic sphere.

The Report consists of several brief introductory addresses to the Colloquium, a comprehensive appendix containing all the major international human rights instruments and five resource papers dealing with a range of important contemporary issues of international law and its application in domestic tribunals. For example, the vexed question of the relative priority of civil and political rights as opposed to social, economic and cultural rights is dealt with in the Indian context by Justice P. N. Bhagwati in a paper entitled 'Fundamental Rights in the Economic, Social and Cultural Context', while Justice Kirby presented a paper dealing with 'The Domestic Application of International Human Rights Norms'.

In accordance with the practice of this type of Commonwealth meeting, the proceedings of the Colloquium were not recorded, however at the end of the meeting the Chairman released a statement summarising the discussion which has become known as the 'Bangalore Principles'. While these priciples have no legal status, they provide an interesting insight into how such a diverse group of international jurists sees the status of international human rights norms at domestic law in common law jurisdictions.

The principles point out that international human rights and freedoms find expression both in the human rights instruments, and in the national and

international jurisprudence concerning the application and interpretation of human rights and freedoms.

They go on to explore the question of the extent to which international norms can be said to be part of domestic law in common law jurisdictions. While pointing out that international conventions cannot be enforced by national courts until they are incorporated into the domestic law by legislation, the principles welcome the 'growing tendency for national courts to have regard to these international norms for the purpose of deciding cases where the domestic law . . . is uncertain or incomplete' because that tendency

> respects the universality of fundamental human rights and freedoms and the vital role of an independent judiciary in reconciling the competing claims of individuals and groups of persons with the general interests of the community.

Where the domestic law is unambiguiously inconsistent with an international human rights instrument to which the State is party, the national court must apply domestic law. However, in such cases, according to the principles,

> the court should draw such inconsistency to the attention of the appropriate authorities since the supremacy of national law in no way mitigates a breach of an international legal obligation which is undertaken by a country.

The principles point out that traditional legal training has tended to ignore the international dimension of human rights issues, leaving judges and practising lawyers 'unaware of the remarkable and comprehensive developments of statements of international human rights norms', and advocates better provision for education and information dissemination in this area.

The principles conclude by recognising that legal professionals have a unique role to play in the administration of justice with respect to fundamental human rights and freedoms.

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