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LAWS2203 Corporations Law 1st Semester 2010

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QUESTION 1 – D (72)

Part A

The question of whether FIs share purchase was valid depends on whether the loan of \$2million given by CDES was a valid financial assistance ('F/A') transaction. This analysis is outlined below. [explain why F/A]

1) General Rule

Under s260A(1), a company may give F/A for another to purchase shares in the company where either subsections (a)-(c) are satisfied. Those requirements are that the F/A doesn't materially prejudice the company, that it is approved by shareholders under s260B, or the assistance is exempted under s260C.

On close analysis, it is obviously that none of the exemptions of s260C apply [explain], nor was it approved by shareholders under s260B because only Rocky and Simon agreed to it, and under s260B, all ordinary shareholders must agree or a special resolution (75% of those entitled to vote) needs to occur. [✓] That doesn't happen here.

The question is whether the transaction didn't prejudice the company.

2) Material Prejudice

ASIC v Adler established that material prejudice can be assessed by reference to the net transfer of value [✓], and the impoverishment test (*Burton v Palmer*) asks whether the company diminished its financial resources as a result of the F/A. [✓]

Here, it is arguable that both of these tests lead to the conclusion that the F/A was not valid under s260(1)(a), for the following reasons.

First, the intention was to stabilise the share price, and this ultimately failed. In turn, the share price has fallen dramatically and now the company has a \$2million deficit. Under the *Burton v Palmer* test, the company has diminished its financial resources. [✓]

Similarly, putting aside the legality of the transaction, *ASIC v Adler* tells us that where the rights received are materially less than the price paid, there is material prejudice. Here, the loan of \$2million is significantly less than the rights received (reduced share ownership in CDES), so the F/A fails here. [✓ good].

3) Timing

s260A(2) states that the F/A may be given before or after, so is not an issue here.

4) Voting Procedure

The F/A must be approved by a special resolution or a resolution of all the members (s260B) – this didn't happen, so the F/A is not valid. [✓]

5) s260D

Despite the F/A not being valid because of the breach, s260D(1) states that the validity isn't affected.

However, R & S can be held liable under s1317E for breaching s 260A, by virtue of their involvement. [✓]

6) Conclusions

The F/A is valid because of s260D, but the share issue may not be valid. Similarly, the company has the power to issue shares under s124(1), so there is no problem here. Again, the only issue with the share issue itself is failure of process (s248A was not followed, ie. an ordinary resolution or a unanimous board meeting) plus failure to notify under s254X the company. [✓] Similarly, there is a failure to comply with s254D(1) that shares be offered first to the company [*only with Pty Co's].

Therefore the F/A doesn't affect the share issue because it's captured by s260D, but failure to comply with the procedural requirements of s248A, s254X and s254D(1) makes the issue invalid.

7) Who can take action?

The company can take action under the oppression remedy or s232, or the directors themselves. [ASIC?]

Part B

Whether or not Tina has standing depends on whether the requirements of ss236 & 237 for the statutory derivative action (SDA) are met. [✓]

1) SDA Standing

A person can commence a claim on behalf of the company in the company's name (s236(2)) where the person has standing under s236(1)(a) and has successfully been granted leave (s236(1)(b)). [✓]

Tina needs to prove she is a member under s236(1)(a). Here Tina is undoubtedly a member as she is a majority shareholder in the company. [✓]

The question is whether she has been granted leave under s236(1)(b). To get leave, Tina must fulfil the requirements of s237(2)(a)-(e). They are as follows:

- a) Probable the company won't bring an action themselves
 - Here, Tina has already requested the company take legal proceedings against FI, and the response from the board was that the company would not pursue proceedings. This is clear evidence the company won't bring proceedings itself. [✓]
- b) Applicant must be acting in good faith
 - Here, Tina's actions might be motivated out of hate of Rocky (given Rocky's statement about the vendetta to Tina) which would obviously show Tina was not acting in good faith [✓]
 - However, given the enormity of the sum, it is more likely T will be acting in good faith because she's concerned about the company's financial wellbeing
- c) The application must be in the company's best interests
 - Here, *Swanson v Pratt* tells us the best interests are judged by reference to the character of the company, and the business etc. Here, despite the high threshold, it is in the company's best interests because the tax on the services is likely to hurt the company, and it can't afford to give out large loans
- d) There must be a serious question to be tried
 - Here, there is the sum of \$2million to be tried – this is sufficient [✓]

e) 14 days notice to the board

- Here Tina has not yet approached the board about the SDA action, so may fail here, but the court may disregard this where there is good reason why there was no notification.

Conclusion

Tina has standing to bring the SDA because she is a 'member' [+ the office] under s275(1)(a), and is likely to be granted leave under s236(1)(b) for the above reason.

Part C

The following breaches may have occurred.

1) Tina

Tina may have breached her duty to exercise care, skill and diligence under s180 for failing to attend the general meeting. This is because *Daniels v Anderson* states that all directors are expected to attend meetings [board meetings].

The test of s180(1) is that they've failed to exercise the duty to the extent of a reasonable person. Here, a reasonable person would have attended meetings, so T has breached the statute and common law.

2) Rocky

I – Conflict of Interest

Rocky has a CL duty to preclude from dealing on behalf of the corporation from engagement that create a conflict of interest (*Transvaal*).

Subsequent to this, there is a statutory duty to disclose (s191) any material personal in a matter relating to a transaction.

Here, Rocky failed to [check facts] disclose he was a Director of another company, thus breaching s 191, and also entered into a transaction w CDES in which he had a personal interest (as owner of FI). In the absence of full disclosure (*Winthrop*) which on the facts looks not to have happened, Rocky has breached the CL duty. [remedies?]

II – Duty of Care

Rocky has breached his duty of care in relation to failing to keep accurate records as required by *ASIC v McDonal* . [ASIC v Adler?]

III – Duty to act in good faith

Rocky has also breached s181 to act in good faith and for the benefit of the company because he is doing an *ASIC v Adler* type thing, and the transaction didn't help the company.

- Proper purpose (s181(1)(b))
- Common law (Greenhalgh)