COMPANIES AND SECURITIES LAW REVIEW COMMITTEE

Discussion Paper No. 1

FORMS OF LEGAL ORGANISATION FOR SMALL BUSINESS ENTERPRISES

1984

COMPANIES AND SECURITIES LAW REVIEW COMMITTEE

The Companies and Securities Law Review Committee was established late in 1983 by the Ministerial Council for Companies and Securities pursuant to the inter—governmental agreement between the Commonwealth and the States on 22nd December, 1978.

The Committee's function is to assist the Ministerial Council by carrying out research into, and advising on, law reform relating to companies and the regulation of the securities industry.

The Committee consists of five part—time members, namely,

Mr. Reginald I. Barrett
Mr. David A. Crawford
Professor Harold A.J. Ford (Chairman)
Mr. Anthony B. Greenwood
Mr. Keith W. Halkerston.

The full—time Research Director for the Committee is Mr. John B. Kiuver.

The Committee's office is at Level 24, M.L.C. Centre, 19—29 Martin Place, Sydney, New South Wales, 2000, adjacent to the office of the Secretariat of the Ministerial Council.

General Aims of the Committee

To develop improvements of form and substance in such parts of companies and securities law as are referred to the Committee by the Ministerial Council.

For that purpose to develop proposals for laws –

* which are practical in the field of company law and securities regulation;

* which facilitate, consistently with the public interest, the activities of persons who operate companies, invest in companies or deal with companies and of persons who have dealings in securities; and

* which do not increase regulation beyond the level needed for the proper protection of persons who have dealings with companies or in relation to securities.

In the identification of defects and the development of proposals to have regard to the need for appropriate consultation with interested persons, organisations and governments.

The Corporate Form Reference from the Ministerial Council

The Commiteee has received a general reference from the Ministerial Council to inquire into, and review, the question of the use of the corporate form.

As part of that reference, the Committee has been directed to have regard to the following matters –

(i) Issues relating to proprietary companies including:

(a) whether the existing classification of proprietary companies is appropriate and, if so, whether there should be any criteria for the incorporation of proprietary companies in Australia;

(b) the suitability of the provisions of the Companies Act 1981 in relation to the regulation of proprietary companies;

(c) the obligations of proprietary companies to make public disclosure, particularly in the light of their limited liability; and

(d) the desirability of abolishing the distinction between exempt and non-exempt proprietary companies.

(ii) The desirability and extent of a requirement for a minimum paid-up capital or authorized minimum capital.

(iii) The various forms of company organisation and incorporation of businesses that should be made available to intending entrepreneurs and the catergorisation of users of corporate forms.

(iv) Any related matters.

The Committee has decided to consider first, the various forms of organisation of businesses that should be available to intending entrepreneurs with particular reference to the structure of "small businesses". In the course of dealing with this some of the other matters listed will come into consideration.

Aim of this Discussion Paper

The Committee's aim in preparing this paper is to raise for consideration the issues relating to the provision of forms of legal organisation for small business enterprises.

The paper is in no sense a draft report. It adverts to possible changes in the law at this stage for the limited purpose of stimulating thought on specific issues.

Invitation for Responses

The Committee intvites interested persons to give to the Committee their written response on the issues raised in this paper.

The Committee will assume that it is free to publish any response, either in whole or in part, unless the respondent indicates that the response is confidential. In any event, all respondents will be listed in the Committee's report to the Ministerial Council.

Responses should be sent o:

The Research Director,
Companies and Secuirties law Review Committee,
Level 24,
M.L.C. Centre,
19-29 Martin Place,
Sydney NSW 2000

By Monday, 22nd October, 1984.

Synopsis

This paper raises for discussion the Possibility of new legislative provisions for the formation of "incorporated partnership companies".

The new form could be of interest to -

* business enterprises which are unwilling to seek incorporation under existing companies legislation; and

* small business enterprises already registered under the companies legislation which might prefer to have the benefit of a more flexible day—to—day regime.

For entrepreneurs the main advantages of the new form may be -

* corporate personality enabling, among other things,

  · the members of the enterprise to be employees of the company; and

  · the raising of finance by the creation of floating charges;

* limited liability;

* absence of any legal duty to have accounts audited or to lodge accounts on a public register;

* abolition of the distinction between proprietors and directors;

* regulation of internal relations by rules appropriate to a partnership rather than those traditionally associated with a company;

* a minimum of administrative detail, the only on-going filing requirements being those related to -

  · an initial form of application for registration;

  · return of change in particulars where such changes occur;

  · triennial returns; and

- forms associated with registration of charges; and

* the only records required to be kept by each company being –

  - register of members showing the extent of each member's interest;

  - accounting records; and

  - register of charges.

Incorporated partnership companies would enjoy many of the benefits of traditional partnerships, including minimal recording and reporting requirements. They would have the added advantage, not available to partnerships, of a form of limited liability. The legitimate interests of creditors and others dealing with an incorporated Partnership company obviously must be taken into account. it is contemplated that the protection of limited liability for members would be defeasible in the event of insolvency for the purpose of recovering company assets improperly disposed of or the value thereof and imposing unlimited liability on members where there has been undue delay in bringing the company's trading activities to an end where it can be shown that the company continued to trade while insolvent.

For governments the principal advantage of the proposed incorporated partnership company might be reduced responsibility to enforce lodgment of returns (Particularly annual returns) with consequent savings of processing costs and greater opportunity for reallocation of resources to other functions, such as investigations of failed companies.

The interests of the public would require that —

* each member have power to bind the company in the same manner as in a partnership;

* a fund be established to finance liquidators in investigating and proceeding against members of failed companies;

* provision be made for more effective action against members of a failed company with a view to recovering the value of company assets improperly disposed of;

* the imposition of Unlimited liability on members of a failed company who have been shown to have acted negligently or improperly in allowing the company to continue trading, but without imposing penal liability in the absence of fraud for such mal-administration; and

* that some of the complexities of other areas of company law be excluded so that –

  · if the company has share capital, no partly paid shares should be allowed to be issued; and

  · the company is not to have capacity to act as trustee under an express trust.

The Committee invites responses on the particular questions raised in the paper and on these further questions:

* Do the provisions in the Companies Codes impose unnecessary burdens on small businesses?

* If an incorporated partnership company structure similar to that described in this paper became available, would you –

  · use it or recommend its use?

  · await the use of it by others and act in the light of their experience?

Table of Contents

Conversion of a company registered under the Companies Act or Codes to an incorporated partnership company

Elimination of the category of exempt proprietary company.

CHAPTER 1

THE FORMS OF LEGAL ORGANISATION CURRENTLY PROVIDED FOR SMALL BUSINESS ENTERPRISES

"Small Business" Defined

101 The Committee takes the term "small business" to refer to those business enterprises which are conducted by a single entrepreneur or by a small group of co-entrepreneurs. The normal maximum membership of such groups, should be taken to be twenty persons. That maximum has applied to business partnerships except in the case of certain declared professions or callings.[1]

102 Persons who embark on a small business enterprise and who do not want to be sole traders currently have a choice of legal organization from the following range —

* unincorporated partnerships governed by partnership legislation of the States and
* Territories;

* unincorporated limited partnership available in Queensland, Western Australia and Tasmania;

* registered company governed by the companies legislation in force in each state and the Territories; and

* trading trust.

The Advantages and Disadvantages of the Existing Forms of Organization

103 Unincorporated Unlimited Partnership. The unincorporated partnership exhibits the advantages of —

* being easily formed by agreement;

* being provided by the Partnership Acts with a standard set of rules as to the relations of partners to each other which may be excluded or modified by agreement; and

[1] Companies Act 1981 (Cth) and Companies Codes s33.

* being subject to a minimum of regulation as a legal form, the only returns required being those stipulated under Business Names legislation.

104 The principal disadvantages are —

* the legal form is not a separate legal entity;

* members cannot in law be employees of the enterprise;

* no member enjoys limited liability in respect of the debts of the partnership; and

* floating charges cannot be given.

105 Limited partnership. A limited partnership available under legislation in Queensland, Western Australia and Tasmania has general partners who are liable without limit for the debts of the partnership and limited partners whose liability is limited to the amount of their contributions of capital provided they have left management to. the general partners.

106 A limited partnership has the advantages over an incorporated company or trading trust of —

* simplicity of formation;

* being provided in the partnership Acts, as adapted by the Limited Partnership Acts, with a standard set of rules as to the relation of partners to each other subject to modification by agreement; and

* being subject to a lesser degree of registration requirements under the Limited Partnership Acts and the Business Names Acts than would be required under the Companies Act.

107 The principal disadvantages are —

* no separate legal entity is created; and

* there can be automatic removal of the limit on the liability of a limited partner —
  · if he takes part in management;

- if he withdraws any part of his contributed capital; or

- in some cases, as a sanction if statutory formalities are not observed.

108 In those States which provide for limited partnerships little use has been made of that form of organization. It has been reported[2] that in Western Australia only 285 limited partnerships were registered during the period of over 70 years following the enactment of limited partnerships legislation in 1909.

109 Registered company. A registered company formed under the companies legislation is another option widely used. Companies legislation in its current form offers both incentives and disincentives for its use.

110 The main incentives for adopting the incorporated company form are as follows —

* Stability and permanency of the business structure.

* A company is a distinct legal entity with perpetual succession, and consequent ability to

* purchase, hold, convey or otherwise deal with property in its own name;

* employ controllers or members, and thereby provide them with certain benefits, including superannuation entitlements; and

* continue in existence, subject to liquidation, irrespective of changes in its controllers or members.

* Right to sue and be sued in the corporate name.

* Ability to create floating charges.

* A degree of flexibility in respect of the rights and powers that may be attributed to the various classes of members, and the balance of power between the directors and members.

[2] Report presented by Professor R. Baxt to the Corporate Affairs Commission on the viability and desirability of enacting limited partnership legislation for Mew South Wales, November 1982.

* Ability to regulate the transfer of shares and the introduction of additional members.

* Limitation of liability of members to the amount, **if** any, unpaid on their shares.

111 The disincentives are as follows —

* Complexity in formation, requiring adoption and registration of memorandum and articles.

* Continuing administrative requirements as to annual and other returns.

* The maintenance of formal divisions between directors and shareholders.

* Adherence to formal decision—making procedures, requiring that resolutions of directors and shareholders be formally passed, minuted and in certain instances registered (special resolutions), as well as conformity with prescribed notices and relevant time periods.

* The principle of majority rule, be it a simple majority for ordinary resolutions, or a three—fourths majority in respect of special resolutions.

* Disclosure of accounting and other information, involving both time and cost to the company and the Corporate Affairs authorities.

* Legal restraints on the application of corporate assets, including restrictions upon the repayment of capital, declaration of dividends, financing by the company of the purchase of its shares, and loans to directors.

* Liability to official investigation.

* Formalities of the winding up procedure.

112 The reason why companies legislation does not easily suit a small partnership type of company lies in history. Companies legislation stems from the English Companies Act 1862 which was originally framed to meet the needs of large—scale enterprises in which management would necessarily be separated from ownership.

Towards the end of the nineteenth century small private companies seeking limited liability found it beneficial to incorporate under the Companies Act despite its orientation towards companies with a large membership. In the short term the advantages outweighed the disadvantages. In the long term it may be seen that it would have been better to provide special legislation for the incorporation of small companies.

113 Although companies legislation has since been modified in some respects to accommodate proprietary companies, it is still something of a makeshift in relation to them. The small incorporated enterprise in which all members expect to participate in management is required, like any other company, to have the two—tier arrangement of directors and members. This dyarchy introduces unnecessary complexity. In the internal administration of the enterprise, not only must there be meetings of members but also meetings of directors. In many small companies members are confused by their dual role with the result that legal requirements are unwittingly disregarded. One result is that the law falls into disrepute. The concept of duties owed by directors to the corporate entity which may be appropriate in a large—scale enterprise, is out of place in a small enterprise where the mutual confidence between members should attract mutual fiduciary duties between them. In external relations questions as to the authority of the members and directors to bind the enterprise also arise. Moreover, paper work about the company, both within the enterprise and in the Corporate Affairs offices, is generated unnecessarily.

114 The legislative requirement that a company, however small, should have directors cannot be excluded by agreement between the members. Companies legislation does contain other provisions regulating the internal government of the company which can be excluded. Those provisions are designed for the large—scale enterprise. The burden of modifying them to suit a small—scale business rests on the entrepreneurs. Whether they succeed in obtaining a suitable constitution often depends on whether they seek professional advice. It may be better for there to be a law designed for small enterprises which can be adopted with a minimum of modification.

115 Trading trust. A hybrid form of organization of fairly recent development is the corporate trading trust. Its popularity derives largely from a combination of taxation advantages not generally afforded to companies and a somewhat ill-defined species of limited liability. In a typical case, a proprietary company formed with minimum capital becomes party to a deed of settlement by which it undertakes certain trusts and in exercise of powers conferred by the trust instrument, carries on a business, its trustee capacity being

hidden from those with whom it deals. Income of the business, being income of the trust, is subjected to the tax regime applicable to trusts rather than that which applies to companies. The view has been expressed that —

> "The use of trusts for this purpose may fairly be described as a distortion, a distortion which probably would never have occurred but for the difference in treatment for tax purposes between trusts and companies. In general terms, company law - both statutory and general - proceeds on the assumption that it is normal and appropriate for a trading concern to be organised as a company incorporated under the Companies Act. It is not unfair to say that the whole of trust law - both statutory and general - proceeds on the contrary assumption about trusts."[3]

116 Recent divergence in judicial opinion on fundamental matters relevant to creditors' rights in relation to corporate trustees and the uncertainty that those divergences have produced go a long way towards supporting such a view.[4] The position of creditors is particularly vulnerable in the light of the principle that a trustee's right of indemnity out of trust property (being the only worthwhile asset in most cases) is lost if liabilities are incurred in breach of trust.[5]

117 The problems encountered with trading trusts have led the Ministerial Council to propose legislation requiring notification that a corporation is acting as a trustee and providing for personal liability in some circumstances on the part of directors of companies acting as trustees.[6]

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[3] Lehane, "Trading Trusts" in "The Companies Bill 1980 — The Revised Draft", (1980), University of Sydney.

[4] Octavo Investments Pty Ltd v Knight (1979) 144 CLR 360; Re Enhill. Pty Ltd (1983) VR 561; Re Suco Gold Pty Ltd (1983) 7 ACLR 873; Re Byrne Australia Pty Ltd (1981) 1 NSWLR 394; Grime Carter & Co Pty Ltd v Whytes Furniture (Dubbo) Pty Ltd (1983) 7 ACLR 540; Re.ADM Franchise Pty Ltd (1982) 7 ACLR 987; Re Thomas Dawn Nominees Pty Ltd. (1984) 2 ACLC 459; Ford, "Trading Trusts and Creditors' Rights" (1981) 13 MULR 1; Leibler, "Pitfalls of Operating Businesses Through Trusts", (1978) 7 Aust. Tax Rev. 17.

[5] Vacuum Oil Co Pty Ltd v Wiltshire (1945) 72 CLR 319.

[6] Companies and Securities Legislation (Miscellaneous Amendment Bill (No. 2)) 1984. Exposure Draft Cl. 72: Proposed Sections 504A—C

Chapter 2

REFORMS AND PROPOSALS FOR REFORM OVERSEAS AND IN AUSTRALIA

The American close corporation

201 The problems associated with a small enterprise adopting a legal regime designed for large enterprises have also been experienced in the U.S.A. Some States have amended their Business Corporation Acts to include special provisions appropriate to close corporations.[7] They are corporations in which there are relatively few shareholders, all or most of whom desire to participate directly in the day—to—day decision—making and operation of the enterprise. Shareholders in close corporations generally believe that they should be able to establish among themselves working business procedures more akin to those of a partnership than a company. The State—based legislation in the U.S.A. is an attempt to accommodate the needs of such enterprises within traditional principles of corporation law. Recently the Committee on Corporate Law of the American Bar Association has developed a Statutory Close Corporation Supplement to the Model Business Corporation Act drawing on the experience of Close Corporation legislation in the various States.[8]

202 The basic elements of American close corporation legislation are as follows:—

* A simplified form of incorporation to reduce the amount of legal drafting to be done in routine incorporations.

* Subject to the right of participants to be treated fairly, maximum flexibility in the rules governing the internal management of the company. This is achieved primarily by allowing a statutory close corporation, if it so chooses, to operate without a board of directors, and by authorising shareholders to achieve by shareholder agreements the same operational framework that is permitted within a partnership.

Control over transfer of interests to protect the remaining

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[7] O'Neal, Close Corporations Vol. 1, pars. 1.11 ff and 1983 Cumulative Supplement.
[8] Business Lawyer, Vol. 37 No. 1 (1981) p269-311; Business Lawyer, Vol. 38 No. 3 (1983) p1031-1032.

* members and outgoing
* shareholders.

* Maintenance of the limited liability principles applicable to other corporations.

* Arbitration processes for the settlement of internal disputes.

* Power of courts to grant relief in cases of oppression.

* Simplified methods of dissolution.

* Methods by which existing companies can transfer to the new status.

* No hidden or other requirements that might prevent or deter entrepreneurs from wishing to utilise the close corporation legislation.

203 Generally, in the U.S.A. legislative provision for a close corporation has taken the form of sanctioning agreements between shareholders which provide for the government of a small corporation in the manner desired by the shareholders even to the extent of not having directors.

204 It may be that, in the Australian context the objectives of this close corporation legislation can better be achieved by adapting the provisions of partnership legislation to a new form of incorporated partnership company. The partnership legislation is backed up by an accumulation of expository case law of which advantage might be taken. Some businesses may develop from the stage of an unincorporated partnership to an incorporated partnership Company.

The Scottish model of a partnership with a degree of legal personality

205 It is noteworthy that the classical text book on the law of partnership[9] deplores the fact that in English law (which our law follows) a partnership is not accorded legal personality:

> "One feature peculiar to the English law of partnership and distinguishing it from the laws of other European countries and of Scotland, has been and (in large measure) is the persistency with which the firm, as distinguished from the partners composing it, was ignored both at law and in equity. As no one can owe money to

[9] Lindley on the Law of Partnership (14th edn. 1978) 5.

himself, it was held that no debt could exist between any member of a firm and the firm itself: and although courts of equity, in winding up the concerns of a firm, treated the firm as the debtor or creditor of its members, as the case might be, yet this was only for purposes of book-keeping, and in order to arrive at the net balance to be paid to or by each of the partners on the ultimate settlement of their accounts. This non-recognition of the firm was a defect in the law of partnership; and it is to be regretted that the Partnership Act did not go further than it did in the direction of assimilating English law to the Scots law in this respect. Had it done so, the difficulties of suing and being sued, and of dealing with partners abroad, would have been greatly diminished."

The position in Scotland[10] is described as follows:

> "In the case of a Scottish partnership the Act makes detailed and distinctive provision.[11] 'In Scotland a firm is a legal person distinct from the partners of whom it is composed, but an individual partner may be charged on a decree or diligence directed against the firm, and on payment of the debt, is entitled to relief pro rata from the firm and its other partners.' In the subsection just quoted, the intention is to preserve the salient feature of the common law of Scotland as it existed prior to the passing of the Act. Clark[12] explains the law as follows: 'The distinctive or central feature of the Scottish partnership is that it constitute a quasi persona of which the members are agents and sureties, a principle which exactly realizes the notion of a firm entertained by mercantile men both in this country and in England'. It will be seen that the Partnership Act, in section 4(2), accurately reflects the essential feature of the firm in Scotland as explained by Clark. The persona of the firm is kept distinct and separate from those of the partners composing the firm, but the subsection immediately proceeds to qualify that general statement with two subsidiary propositions which tend to interlace the personae of both firm and partners in a way which is entirely unfamiliar in the law of corporations. By the first of those qualifications an individual partner may be charged on a debt or diligence directed against the firm so that the sharp distinction maintained between the liability of the corporation and those of its individual members is lost. By the second qualification any individual partner who has paid a debt of the firm is entitled to relief pro rata from the firm itself and from the other partners. In neither of these qualifications is the major proposition that the firm in Scotland is a legal person destroyed. In both the separate entity of the firm is implicit; but as a result of both that entity is different in its legal consequences from the juristic persona of an incorporated association."

206 The Scottish model suggests a possibility of investing a partnership with some of the attributes of legal personality but

[10] Miller, The Law of Partnership in Scotland (1973) 15.
[11] Partnership Act 1890 (U.K.) s.4(2).
[12] Clark, A Treatise on the Law of Partnerships and Joint Stock Companies According to the Law of Scotland, vol.1, 31.

without all the consequences that flow from incorporation as it is generally understood in Australia. As a result a partnership might be given the power to employ members as employees. That might assist members to arrive at satisfactory superannuation arrangements without depriving them of any taxation advantages which flow from their being a partnership rather than a company. But against that advantage to the members there needs to be weighed the liability of members for the partnership's debts and the difficulty for all concerned in grappling with an unfamiliar concept of qualified legal personality.

Proposal for a Code for Incorporated Firms by Professor Cower

207 A model for an incorporated firm has been proposed by Professor Gower[13]. Much in that proposal has merit particularly in respect of dispensing with the formal director/shareholder distinctions and allowing the incorporated body to act internally according to partnership principles.

208 While the importance of the Gower model is clear, it may be appropriate in Australia to depart from that model in some respects. Professor Cower recommended that all members be given an unalterable entitlement of participation in management and that no variation be allowed in voting majorities concerning ordinary matters (simple majority) and changes in the nature of the business (unanimity). These principles could unduly limit the internal flexibility of an incorporated partnership and make it less attractive and useful. It may be more appropriate for the right of participation in management as well as voting majorities to be subject to members' agreement to the contrary. This accords more closely with partnership law principles.

209 Another and more fundamental area in which the incorporated partnership company concept departs from the Cower model concerns the matter of limited liability. Professor Gower proposed that, if an incorporated partnership was wound up and unable to pay its debts, each member should be under a legal obligation to meet these outstanding liabilities up to a prescribed amount, being a fixed amount per member or a total amount for the firm with each member jointly and severally liable. Such an approach may create a strong disincentive to use the incorporated partnership model in comparison with the present limited liability company structure. A desirable alternative may be to retain the principle of limited liability, subject to a number of qualifications where a company becomes insolvent.

[13] A New Form of Incorporated Small Firms Cmnd 8171 (1981).

Proposal for a Small Enterprises Incorporation Act made by Mr. Athol Yeomans

210 A suggestion for an improved form of legal organization for small enterprises consisting of no more than 10 natural persons has been made by Mr. Athol Yeomans, Executive Director of The Company Directors Association of Australia. His proposal requires "that at least two persons called 'controllers' assume the responsibility for the debts of the small enterprise, in the same manner as sole traders and partners. In return, they will gain the right to trade through a corporate structure without any registration or filing requirements, with a minimum of statutory rules and with the emphasis on self—policing and self—enforcement".

211 The Committee has derived benefit from consideration of the proposal but is not persuaded that it provides a complete answer to the question of the most appropriate form of organization for a small enterprise. The Committee has noted the argument put forward in the proposal that recent legislative changes go far to erode limited liability for managers so that creation of an incorporated partnership with at least two persons subject to unlimited liability, but with no requirement for registration, audit or lodging of accounts may prove an attractive option for a small enterprise. Entrepreneurs may, however, still think that it is more desirable to have limited liability at the outset even if it is defeasible through a finding by the court of fraud, recklessness or negligence in management.

Chapter 3

CRITICAL ISSUES IN DEVELOPING A NEW FORM OF LEGAL ORGANISATION FOR SMALL ENTERPRISES

301 proceeding on the basis that there may be a need for a separate Act or discrete provisions within the existing companies legislation providing small enterprises with access to a simplified corporate form, the following critical issues call for attention —

* eligibility for a new form of organization;
* participation of members in management;
* fiduciary relationships within the small enterprise;
* external relations of the entity;
* transferability of interests;
* retirement from membership;
* protection of creditors;
* withdrawal of a member's capital;
* publicity for accounts and limited liability;
* making more effective provision for post—failure investigations;
* under—capitalization;
* publicity as to paid—up capital;
* winding—up and dissolution;
* early appointment of a provisional liquidator or controlling trustee; and
* liability to taxation.

302 The Discussion Paper will consider these issues within the framework of developing a separate Incorporated Partnership Act, with inclusion of appropriate provisions of the Companies Code by

reference. This is done in order to highlight those matters of particular concern to incorporated partnership companies, and does not indicate any disposition in favour of separate legislation. It is estimated that a separate Act regulating incorporated partnership companies would contain approximately 100 sections as against more than 500 in the Companies Act and Codes. Comments are invited both on the substantive points raised by each of the issues, and on the separate matter of whether it would be preferable to proceed by way of a separate Act, or by amendment to the existing companies legislation.

303 For convenience, in the following treatment the corporate entity is referred to as an "incorporated partnership company". Discussion of the suitability of that title is postponed until the above issues have been considered.

Eligibility for a New Form of Legal Organization

304 The legal provisions as to eligibility for registration should be clear and precise. For many years a distinction has been drawn between partnerships according to the number of members. In general, those with more than 20 members are illegal unless incorporated. There is provision for larger partnerships in certain professions or callings which are declared by the Ministerial Council to be allowed to exist without incorporation. These provisions may provide a suitable way of defining eligibility in the present context so that an incorporated partnership company may have a maximum of 20 members or such higher maximum as is allowed for those professions or callings that have been declared by the Ministerial Council. This maximum may also encourage a realistic expectation that all members may take part in the management of the company.

305 Another issue is whether an incorporated partnership company should be required to have more than a single member. At present all proprietary companies must have a minimum of 2 members, and it may be appropriate to maintain this requirement for incorporated partnership companies. The very notion of a partnership would suggest the need for more than one member. Furthermore a requirement that an incorporated partnership have a minimum of 2 members would go some way to meeting the problems that could occur where a sole member dies and there is possibly a long delay before a legal personal representative is appointed.

306 The Discussion Paper will proceed on the premise that a minimum number of 2 persons will be required for an incorporated partnership company. However the Committee invites submissions on whether it would be useful and appropriate to dispense with this minimum and

allow for single member incorporations.

307 There will be a need for a member or members to reside in Australia or an external territory so that the company's responsibilities to other members of the community can be effectively enforced.

308 There is a question whether membership should be confined to natural persons. It seems likely that the small enterprises most in need of a new form are groups of natural persons and this may favour limiting the membership, both initial and continuing, to natural persons.

309 One consequence of confining membership to natural persons is that while an incorporated partnership company could enter into partnership with natural persons or other bodies corporate, the resulting association could not itself be registered as an incorporated partnership company. That follows from the need to keep the legislation about an incorporated partnership company as simple as possible.

310 A natural person could, of course, hold his interest in the company as a trustee for a body corporate but that would be the result of the law of trusts rather than anything in an enactment about the new form of company.

311 Given that a partnership company has been incorporated, it should be required during its life to observe the requirements as to maximum and minimum membership and as to the residence of a prescribed minimum number of its members. The Companies legislation has for a long time provided that if the minimum membership is not maintained the members are to be personally liable for debts incurred by the company during a period when the membership remains below the minimum. It may be that a similar principle should apply in respect of incorporated partnership companies.

312 The Companies Code, s364(l) (d) makes the reduction of members below the minimum a ground for compulsory winding up. In a later part of this Paper it is contemplated that an incorporated partnership company should be subject to winding up under Part XII of the Companies Code with appropriate modifications. It may be that reduction below the minimum membership and increases above the maximum should provide grounds for winding up, as would failure to observe the residence requirements. Application on that ground could be made by a creditor or a member.

313 Under the Companies Code ss227, 227A and 562, certain persons

are disqualified from taking part in the management of a corporation. These provisions would appear to be desirable in respect of management of an incorporated partnership company. Some provision would need to be made for the case where the operation of s227, s227A and s562 would leave an incorporated partnership company with no person qualified to manage it.

Participation of Members in Management

314 Given the limitation on size of an incorporated partnership company referred to earlier, it is possible to take the provisions found in the partnership legislation as a model for the internal government of this new form of organization. Adoption of this model would mean the vesting of management powers and functions in the members alone without the need for a separate board of directors.

315 The partnership legislation has for many years provided a background of rules against which members of a partnership may, if they wish, draw up their own partnership agreement. If their own agreement is not exhaustive as to their internal government, the partnership legislation has filled the gap in a way which has proved generally satisfactory. Rather than formulate a new set of standard rules for incorporated partnership companies it may be better to write into the new legislation provisions on management which closely follow the partnership model. This would provide access to a substantial body of decided cases on partnership law and avoid much of the uncertainty which often attends legislative innovation. The new legislation would thus provide that the rights and duties of the members in relation to each other and in relation to the company shall be determined, subject to the Act and to any agreement, express or implied between the members, by certain rules drawn from partnership legislation. The legislative rules on internal management would dispense with the notion of directors and substitute the following rules, subject to any contrary agreement between the members:

(a) all members are entitled to share equally in the capital and profits of the business;

(b) the company shall indemnify every member in respect of payments made and personal liabilities incurred by him —

(i) n the ordinary and proper conduct of the business of the company; or

(ii) in or about anything necessarily done for the preservation of the business or property of the company;

(c) a member making, for the purpose of the company, any actual payment or advance beyond the amount of capital which he has agreed to subscribe is entitled to interest at a prescribed rate from the date of the payment or advance but the claim to interest should not rank in priority over the claims of external creditors;

(d) a member is not entitled before the ascertainment of profits to interest on the capital subscribed by him;

(e) every member may take part in the management of the company's business;

(f) no person may be introduced as a member without the consent of all existing members;

(g) any differences arising as to the ordinary matters connected with the company's business shall be decided by a majority of the members, but no change may be made as to the nature of the company's business without the consent of all existing members; and

(h) every member may, when he thinks fit, have access to the company's books and may inspect any of them.

Fiduciary Relationships Within the Small Enterprise

316 So far as these relationships are concerned, partnership legislation provides clear rules which can be easily understood. They are —

* Partners are bound to render true accounts and full information of all things affecting the partnership to any partner or his legal representatives.

* Every partner must account to the firm for any benefit derived by him without the consent of the other partners from any transaction concerning the partnership, or from any use by him of the partnership property, name or business connection.

* If a partner, without the consent of the other partners, carries on any business of the same nature as and competing with that of the firm,he must account for and pay over to the firm all profits made by him in that business.

317 The rules of corporation law are more complicated. Most of the complication arises from the requirement that a company have directors. If that requirement does not apply and if the maximum number of members is small, the partnership rules would seem to be appropriate to the new form.

External Relations of the Entity

318 Given the suggested limitations on the membership of an incorporated partnership company and the resulting analogy with existing partnerships, it would be appropriate to adopt for the new form the agency rules of partnership law. These rules, as adapted for incorporated partnership companies, would take the following form:

> "Every member is an agent of the incorporated partnership company for the purpose of the business of the company and the acts of every member who does any act for carrying on in the usual way business of the kind carried on by the company of which he is a member bind the company, unless the member so acting has in fact no authority to act for the company in the particular matter and the person with whom he is dealing either knows that he has no authority or does not know or believe him to be a member"

319 Other provisions in the partnership legislation, namely, those in the Partnership Act 1892 (N.S.W.) sections 6, 8, 14, 15 and 16 detailing other circumstances in which a firm may be bound also merit adoption.

320 For the purpose of informing the public, an incorporated partnership company should be required to lodge with the Commission a triennial return containing —

* a description of the nature of the company's business;
* addresses of places in which the business is carried on;
* the principal place of business if there is more than one place of business; and
* names and addresses of members at the close of the triennial period.

321 Changes in membership should also be notified. There could be a provision that the returns are evidence of membership for the purpose of determining agency for the company.

322 As the new entity will be a corporation, certain provisions not found in the partnership legislation will be necessary. It will be important to exclude any possibility of application of the doctrine of ultra vires and to provide that when under the Act the company may

be bound by the act of a person it is to be bound in the same way that a natural person would be bound by the act of another person in like circumstances. It will also be necessary to provide that the company has power to do certain things which are appropriate to corporate bodies such as issuing debentures, granting floating charges, allotting shares and making distributions of property in kind.

323 However, because one of the objectives of the new law would be to provide a new form of organization which is not complex and with which creditors may deal with a minimum of investigation, it would be necessary to deny to the new company the power to act as a trustee under any express trust except where it is required to act as trustee by operation of law. There could be a legislative provision that if a person purporting to act on behalf of the company acts so as to lead innocent persons to believe that the company has become a trustee under an express trust, the person so acting, and not the company, shall be the trustee. The denial of power to act as trustee should not extend to cases in which the company is required by operation of law to act as a trustee. Thus statutory provisions applying to such persons as solicitors, estate agents and stockbrokers under which they are to pay certain moneys into trust accounts would be attracted to the company. Moreover, if the company received money as a fiduciary agent and it was required by law to treat the money as a trustee the new legislation should not preclude the company coming under that obligation.

Transferability of Interests

324 In a large company, particularly one which invites the public to take up shares, freedom of members to transfer s-hares is appropriate. Rut in a partnership with a relatively small number of members the identity of the ~members will normally be a matter of importance to all of them. In partnership law no person may be introduced as a member without the consent of all existing members but this may be varied by agreement among the partners. Partnership legislation contemplates assignment by a partner of his share in the partnership but that assignment does not, as against the other partners, entitle the assignee to interfere in the management of the partnership's affairs. Any law providing for a new form of incorporated partnership company might well adopt the position provided for in partnership legislation and allow the members to relax the restriction on transfer by agreement if they so desire.

Retirement from Membership

325 A related matter concerns the question of retirement from a partnership. The Partnership Act makes no specific provision in this

respect, the closest provision being the right of any partner to dissolve a partnership at will at any time. It may be beneficial to include a provision entitling a member of an incorporated partnership company to withdraw at fair value, though this right would need to be qualified to protect the legitimate interests of remaining members and creditors of the company.

326 A retirement might be effected by the purchase of the retiring member's interest by continuing partners so that no funds of the company are disbursed and accordingly no creditors of the company are directly disadvantaged. In these circumstances it is necessary to consider whether there should be statutory provisions for determining the means of resolving disputes between members as to the amount to be paid for the transfer of the interest and whether there should be provision for having the company wound up if disputes of that kind are left to settlement by agreement and agreement is not attained within a reasonable time.

327 Another question is whether the company should be able to pay out a retiring member's interest. Any such power should be subject to there being proper regard to the interests of the company's creditors. In an unincorporated partnership there are no restrictions on the withdrawal by a partner of any part of his interest. Restrictions on that power are there unnecessary as members of the partnership do not, as members, enjoy limited liability. However if members of an incorporated partnership company are to enjoy limited liability there must be some control over the withdrawal of interest, withdrawal might be permitted subject to all members declaring that the company is expected to be able to pay its debts as they fall due throughout the ensuing 12 months. Further, the amount withdrawn could bemade repayable to the company under a court order in proceedings in liquidation in respect of the company if in the ensuing 12 months after withdrawal the company were unable to pay its debts as they fell due.

Protection of Creditors

328 If the community is to accord to all members of an incorporated partnership company the privilege of limited liability there must be more regulation of it than would be necessary for an ordinary partnership or a limited partnership. If creditors of the partnership cannot look to the total assets of all or any of the partners there must be provisions which control the members in their application of the company's funds. The dispositions of funds which are permissible while the organization is a going concern are —

* distribution of profits; and

* disbursement of the funds in normal trading.

329 In addition, some power to buy out a member on retirement prior to the winding up may be allowed but subject to safeguards designed for the protection of creditors. That aspect has been considered above.

Protection by Means Other Than Publicity of Accounts

330 The desire to protect creditors of limited liability companies has prompted requirements for audited accounts or public disclosure of accounts. These requirements can be burdensome for small enterprises. It may be possible to abandon the requirements of audit or lodging accounts in relation to incorporated partnership companies and to require no more than that a small enterprise keep accounting records in such a manner as will enable a profit and loss account and a balance sheet to be readily prepared in a manner capable of being conveniently audited.

331 If that step were taken it would be necessary to ensure that the restrictions on improper disbursement of company funds would be really effective. One possibility is to make full retention of the privilege of limited liability for members of a new form of incorporated partnership conditional on their observance of certain standards. At present, the Companies Code s556 makes the limitation of liability of directors and other managers defeasible on a showing that a debt was incurred recklessly during their management and enables recovery of the debt from them personally. The principle of s556 appears suitable for application in respect of an incorporated partnership company to the members of the company.

332 An additional need is some provision to discourage improper disposal of a company's assets in disregard of the interests of creditors of the company. In the liquidation of an insolvent incorporated partnership company, power might be given to the Court to order that persons who were members of the company at the time of a misapplication of the company's assets should be liable to pay to the company the value of what was misapplied together with the value of any goodwill, profits or gain that might have been made from the asset. The suggestion is based on the principle which underlies s453 of the Companies Code. Liability might be extended to persons who were members within 12 months before the misapplication. Such former members and persons who were members at the time of misapplication could avoid liability on showing that the misapplication occurred without their authority and, where they had reason to suspect misapplication, they made reasonable efforts to enable the company

to recover the asset or compensation. A general power should reside in the Court to relieve from liability persons who had acted honestly and reasonably and ought fairly to be excused. The principle might appear in some such legislative form as the following clause. This clause has not been drafted by Parliamentary Counsel and it is provided here for the sole purpose of revealing the implications of the suggested principle.

(1) This section applies where an incorporated partnership company has been wound up or is in the course of being wound up and the company was or is unable to pay all its debts in full.

(2) Where the court is satisfied that at any time since the formation of the company an asset of the company was disposed of otherwise than

(a) in a proper distribution of profits;

(b) for a purpose reasonably incidental to the proper conduct of the affairs of the company for the benefit of the company and with proper regard to the interests of all the company's creditors; and

(c) for other lawful purposes

the court may order that a person who was a member at the time of the disposition or within 12 months prior to that time shall be personally responsible without any limitation of liability for payment to the company of an amount equal to the value of the asset.

(3) For the purposes of this section, the value of the asset includes the value of any goodwill, profits or other gain that might have been made from the asset.

(4) The court shall not make an order under this section —

(a) if the person against whom the order is sought satisfies the court that the asset was disposed of without his express or implied consent; and

(b) where it is shown that the person against whom the order is sought had reason to suspect, whether within or outside the period when he was a member —

(i) that the asset was disposed of; and

(ii) that it was disposed of otherwise than in the ways set out in sub—section (2),

he proves that he made reasonable efforts to enable the company to recover the asset or to obtain compensation for loss caused by the disposition.

(5) The court shall not make an order under this section if the person against whom the order is sought satisfies the court that he acted honestly and reasonably and ought fairly to be excused.

333 To the extent that such a clause would not cover cases within s453 of the Companies Code a provision adapting s453 to the new form of company would also seem desirable.

334 A suggestion that a standard of propriety of expenditure such as that in the foregoing clause, be expressed in terms of being reasonably incidental to the proper conduct of the affairs of the company for the benefit of the company and with proper regard to the interests of creditors may well attract the criticism that the standard is not precise.

335 However, the concept of expenditure "reasonably incidental" to the proper conduct of a business is supported by a substantial body of interpretative case law in company law.

336 It may still be objected that a law designed for small business enterprises should provide express guidance for particular cases as to what is within the law and what is outside it. However, any law in this area will have to cover a wide variety of business enterprises and it may not be possible to provide a detailed catalogue of the possible permissible kinds of expenditure which may be made for every different kind of business. The principle can be stated in general terms and some unpredictability in its application appears unavoidable. However, as between the general community which stands to be prejudiced by abuse of the privilege of limited liability and entrepreneurs who wish to have that privilege, it seems better that the disadvantage of unpredictability should rest on those who seek the privilege.

Making More Effective Provision for Post—Failure Investigation

337 Before reliance for protection could be shifted from audits or publicity of accounts to a post-failure deprivation of limited liability it would be necessary to ensure that the legislation could

readily be put into operation. In many instances of company failure there is inadequate investigation of their administration because of lack of funds available to liquidators.

338 One partial solution to this problem may be the establishment in each relevant State and Territory of a companies liquidation recovery trust fund. To that fund all incorporated partnership companies might be required to contribute on being registered and on lodging a triennial return. A liquidator could be empowered to apply to the Court ex parte for an order that an amount be advanced from the fund to him to defray the costs of investigations and proceedings undertaken- with a view to obtaining a court declaration under the provisions described above.

339 The court could be empowered to order provision of an amount out of the fund, with or without conditions, on the court being satisfied that there existed a prima facie case for a declaration. The fund might also be available to support other proceedings by a liquidator to recover property or money such as those relating to voidable preferences. It might be provided that if proceedings in which the liquidator was so assisted resulted in recovery, a proportion of the amount recovered should be paid to the companies liquidation recovery trust fund.

340 The recovery trust fund principle may have application to all company insolvencies, though in the context of this Discussion Paper, it is confined to incorporated partnerships.

Under—capitalization

341 The Committee has given preliminary consideration to the question whether the court should have power to declare that members of a failed incorporated partnership company should be personally responsible for the company's debts where the company has been under-capitalized. The Committee has considered this question in conjunction with the further question whether there should be a requirement that a company may not commence business without a minimum paid-up capital.

Should the law prescribe a minimum paid—up capital?

342 Prescription of a minimum paid—up capital could be relevant to the general public interest as a means of keeping frivolous incorporations to a minimum. Such prescription is also commonly suggested as a response to perceived abuses associated with some $2 companies. The criticism that it is wrong to form a company with no more capital than $2 may be valid in respect of some companies but

not others. There may be no more in the criticism than a judgment that if the kind of business carried on calls for substantial financial resources, those who form the business should be prepared to subscribe an amount of capital appropriate to the particular type of business.

343 To say that persons dealing with a company have an interest in the amount subscribed by its incorporators or controllers is not to say that persons dealing with a company can legitimately expect that the capital will be available should the company go into liquidation.

344 Loss of paid—up capital in the course of normal trading may occur even when a company is adequately capitalized. The company may have observed all the requirements of the law as to the maintenance of capital yet have lost its capital in trading. This is an inescapable risk of business and creditors of a company cannot expect the law to relieve them of it. At the same time, however, creditors of an adequately capitalized company have the satisfaction of knowing that the proprietors have enough faith in their enterprise to put their own funds at risk. It is doubtful whether a requirement for minimum paid—up capital can fulfil any higher function. Paid—up capital is no true indication of the current worth of a company or of its ability to meet its debts: it is merely an historical figure.

345 Even if it be accepted that incorporators and controllers should be judged in the light of the stake they commit to the company, there is a question whether the legislature or a regulatory authority should attempt to prescribe a minimum stake. Various overseas jurisdictions including the United Kingdom (public companies), the Federal Republic of Germany and some States of the U.S.A. impose minimum capital requirements, but the amounts differ considerably and in many instances appear to be aimed at discouraging frivolous incorporation, rather than ensuring a substantial capital base. Even if it were possible or desirable to set a minimum capital, the amount appropriate for some types of companies may be quite low. It would thus be necessary for the power to prescribe minimum capital to be exercised with discrimination. Mow that a company may be formed without stated objects there may be difficulty in prescribing in advance a minimum capital given the uncertainty as to the types of activity in which the company might engage. Public recording of the current activities of a company and readjustment of minimum capital requirements in the light of changes in those activities could require administrative effort out of proportion to any likely benefit to the public.

346 Minimum paid—up capital requirements would constitute a burden on all companies for the sake of giving some comfort against those companies which abuse limited liability.

347 A further problem would lie in the need to ensure that minimum capital provided in a non—cash form was not over—valued. This would require the enactment of legislative controls, the lodging of returns and administrative action in a manner not consonant with the aim of reducing complexity in the law about incorporated small enterprises.

348 A better way of providing for creditors may lie in making members of an insolvent company liable without limit where they have either failed within a reasonable time to cause the cessation of the company's business, to call a meeting of members and creditors, or to arrange for adequate capital to be put into the company.

349 These principles might take the following legislative form and be applicable to insolvent incorporated partnership companies. This clause is included merely for clarification, and was not drafted by Parliamentary Counsel.

(1) The court may make a declaration (of personal liability] if it is satisfied that during the period when the person in respect of whom the declaration is sought was a member of the [insolvent] company —

there were reasonable grounds to expect that the company would not be able to pay all its debts as and when they became due and the person in respect of whom the declaration is made, during the period when he was a member, made no reasonable efforts within a reasonable time, to cause —

(i) the cessation of the company's business;

(ii) a meeting of the company's members and creditors to be convened; or

(iii) the equity capital available to the company to be increased by contributions of the members to an amount adequate to enable the company to pay all its debts as and when they would become due;

(2) the court shall not make a declaration under sub—section (1) if the person against whom the declaration is sought proves (on the civil standard] that at all material times he did not have reasonable grounds to expect that the company would not be able to pay all its debts as and when they would become due.

This would place an onus on members of an incorporated partnership company to take reasonable steps to monitor the company's financial position.

Publicity as to Paid—up Capital

350 A possible alternative to the adoption of a minimum paid—up capital requirement would be to oblige companies to disclose on their letterhead etc. their actual paid—up capital. By this means creditors would be advised of the equity basis of the company.

351 However, this proposal raises problems. In the first instance the information could be misleading to creditors and prejudicial to the legitimate interests of companies. For example, one company may have a large paid—up capital but few assets and considerable debts, while another company has an insignificant paid—up capital but considerable assets and no major liabilities. Some creditors may be misled into believing that the former company is a better risk than the latter.

352 Secondly, the requirement would need to be supported by controls designed to prevent over—valuation of non—cash contributions to paid—up capital.

Summation on Protection of Creditors

353 If reliance were placed on the effective operation of

(i) a provision comparable with s556 of the Companies Code,

(ii) a provision requiring compensation for assets improperly disposed of, and

(iii) a provision under which members of a failing company would lose the benefits of limited liability if they failed to take timely action to cease trading,

much of the cost of ensuring protection for creditors would fall on those who did not adhere to proper standards rather than being spread over all corporate enterprises including those which were properly conducted.

Winding—Up and Dissolution

354 If members of an incorporated partnership company are to have the benefit of qualified limited liability it will be necessary in the interests of creditors that the winding—up be carried out by a

registered liquidator. The provisions of the Companies Code as to compulsory winding—up and a creditors' voluntary winding—up provide a well established system which could be adapted to the new organization, pending the overall review of insolvency law which the Australian Law Reform Commission is to conduct.

355 The grounds for a compulsory winding—up may be adapted from those in the Companies Code with the addition of those in the Partnership Acts.

356 where a declaration of solvency can be made by the members, the conduct of the winding—up could be left to the members. However provision would need to be made for a members' voluntary winding—up to be taken over by a registered liquidator once it appears that the company cannot pay all its debts in full.

357 The power of members to bring about a members' voluntary winding—up should require the concurrence of such number of members as is specified in their agreement.

358 Provisions about dissolution of the corporate entity comparable with those in the Companies Codes would be necessary.

Early Appointment of a Provisional Liquidator or Controlling Trustee

359 To meet cases where it is apparent to the members that the company is failing there seems to be merit in a provision whereby they could appoint an official liquidator as a provisional liquidator of the company in advance of meetings of members and creditors. The appointment would last for a specified period within which meetings of members and creditors could be called. That period could be extended by the NCSC but should cease upon the appointment of a liquidator in a winding—up. The provisional liquidator would be eligible to be appointed as the liquidator in a winding—up.

360 An alternative approach would be to enable the prompt appointment of a Controlling Trustee where it is apparent that a company is failing. Such a Controlling Trustee would take over control of the company's business in much the same way as is done in respect of an individual trader's business under the Bankruptcy Act 1966 (Cth).

361 It may be that what is here proposed is worthy of adoption in respect of all companies.

Liability to Taxation

362 It is beyond the scope of the Committee's function to make recommendations with respect to taxation matters. It would nevertheless be unrealistic for those matters to be disregarded.

363 If incorporated partnership company provisions of the kind foreshadowed were enacted, bodies incorporated under it would be "companies" for the purposes of the Income Tax Assessment Act 1936. Each such body would therefore be taxed on its separate income at company tax rates, while distributions of profits to members would be subject to tax in their hands. All such bodies would also be "private companies" for income tax purposes and would accordingly be subject to the "sufficient distribution" provisions of Division 7 of Part III of the Income Tax Assessment Act.

364 Division 7 has been seen by some commentators as impairing the ability of small businesses to retain funds and hence their capacity to finance growth by internal funding, with consequent adverse effects on debt/equity ratios and disadvantages to shareholders as against proprietors of unincorporated businesses. The proliferation of trading trusts and the recent renewed popularity of traditional limited partnerships are in large measure attributable to the perceived taxation disadvantages faced by private companies.

365 Taxation considerations alone should not, it is suggested, be allowed to unduly colour judgments on the desirability or otherwise of incorporated partnership company pro-visions of the kind outlined in this paper. However if the incorporated partnership company has merit, the tax laws should promote and facilitate that concept, just as these laws should not act as an artificial stimulus to the continuation of the present forms of trading trusts and limited partnerships, where the shortcomings of these entities are acknowledged. Accordingly attention might be focused anew on proposals that have been made elsewhere for reform of the system of private company taxation. The Taxation Review Committee (Asprey Committee) in its Preliminary Report of June 1974 put forward a proposal to allow certain private companies to elect to be taxed as partnerships. Such a system was seen as offering "at least low income shareholders in small enterprises the opportunity to escape any excessive taxation of company profits that may still exist".[14]

[14] Report, para. 8.73(d). The Campbell Committee Report (1981) contained similar views: see para. 14.89.

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OTHER ISSUES

The following other issues call for consideration —

* administration of the legislation;
* name of the organization;
* interests that may be created in the new organization;
* accounting records and books;
* legal proceedings;
* remuneration to members for acting in the business of the organization;
* oppression of members;
* powers of inspection and special investigation;
* arrangements and reconstructions;
* registration of charges;
* receivers and managers;
* official management;
* conversion of an existing company to an incorporated partnership company; and
* elimination of the category of exempt proprietary company;

Administration of the Legislation

401 As the new form of organization would be a corporation, administration of the legislation would fall within the scope of the Formal Agreement of 22 December 1973 under which the Ministerial Council, the National Companies and Securities Commission and the various State and Territorial Corporate Affairs authorities operate.

Name of the Organization

402 Because the new organization would have the same limited number of members as a partnership and the relations of the members among themselves would be similar to those of partners, the name of the new entity should reflect that similarity. The name should also indicate that the entity differs from an ordinary partnership and a limited partnership in that it is incorporated. It would also be important to indicate that in normal circumstances the liability of the members is limited. Accordingly the new entity might be described by the words "limited partnership company" or the abbreviation "L.P.Co.". Inclusion of the term "company" would distinguish this entity from unincorporated limited partnerships available in Queensland, Western Australia and Tasmania. An alternative name may be "incorporated partnership".

403 If the incorporators were satisfied to have the entity bear a number as its name there would be no need for a name to be reserved. If the incorporators desired some other name it would be necessary to seek reservation of that name in the manner provided for in the Companies Code.

Interests that may be created in the new organization

404 The new organization should be free to create whatever interests in the enterprise the members may desire save that in order to avoid complexity of legislation there should be no power to issue shares that are partly paid. By excluding the power to issue partly—paid shares the need to have provisions about calls, forfeiture, surrender and charges on uncalled capital would be avoided.

405 A prohibition on offers of the company's shares, debentures or other interests to members of the public would also be necessary.

Accounting Records and Books

406 The new organization should be required to keep accounting records but, as explained earlier, there should be no requirement that the accounts be audited or that financial statements be lodged on a public register. The accounting records would need to be kept in such a manner as would enable a profit and loss account and a balance sheet to be readily prepared and capable of being conveniently audited.

407 The only records that the new organization should be required to maintain are a register of members showing the interests of members and a register of charges.

408 Any member should have access to the books but this could be made subject to the agreement of the members.

409 Various provisions in the Companies Codes about location of records and computerized records could well be adapted to apply to the new organization.

Legal Proceedings

410 There will need to be provisions about service of documents on the partnership company. It is suggested that a document may be served on an incorporated partnership company by –

(a) delivering a copy to one member who resides in Australia or an external Territory; or

(b) by delivering a copy at the principal place of business of the company within the relevant State or Territory to a person having the control or management of the company's business there.

411 A provision requiring the incorporated partnership company to give security for costs in circumstances where the Companies Codes require it from a company would also be needed.

Remuneration for acting in the business of the organization

412 The rule in partnership legislation is that, subject to the agreement between the partners, no partner shall be entitled to remuneration for acting in the partnership business. To maintain a starting position similar to that, the rules about members of the proposed organization should contain a similar provision. It would be open to members to make provision in the agreement for their acting as employees of the corporation.

Oppression of Members

413 The provision in partnership legislation that no majority of partners can expel any partner unless a power to do so has been conferred by express agreement between the members should be adopted. The remedies against oppression provided by Part IX of the Companies Code are also appropriate for application to the new organization.

Powers of Inspection and Special Investigation

414 Incorporated partnership companies will enjoy the benefit of limited liability for members and minimal reporting requirements. It

is therefore necessary in the public interest that in appropriate circumstances their affairs be open to scrutiny. The powers given to the Commissions to investigate the affairs of corporations, found principally in Part II, Division 1 of the Companies Code, as well as s541, s542 and s551, should be made applicable to incorporated partnership companies.

415 There could also be a case where, in the interests of the public, a special investigation of the conduct of an incorporated partnership's affairs is needed. The provisions of Part VII of the Companies Code apply to corporations and there is no reason to exclude them from legislation regulating the new organization.

Arrangements and Reconstructions

416 There could be occasions when 2 or more incorporated partnership companies desire to merge or when an incorporated partnership company wishes to enter into a scheme of arrangement with its creditors. Most of these companies will have such a small membership that there may be thought to be no need to apply the provisions of Part VIII of the Companies Codes to an incorporated partnership company inasmuch as the attitudes of all members could be ascertained and if they were not unanimous about a proposed arrangement it should not proceed. However it may be thought undesirable to deprive the members of the new organization of a facility which they would ~joy if their company were a registered company.

Registration of Charges

417 The policy behind Part IV Division 9 of the Companies Codes that there should be a public register of charges given by companies appears to be relevant to charges given by an incorporated partnership company.

Receivers and Managers

418 Some of the provisions of Part X of the Companies Codes will apply of their own force to an incorporated partnership company. It is desirable that Part X apply fully to such a company.

Official Management

419 There might be instances where official management would be appropriate for an incorporated partnership company which is in a poor financial state.

420 The provisions of the Companies Codes relating to official management are capable of being adopted in relation to~ an incorporated partnership company.

Conversion of a company registered under the Companies Act or Codes to an incorporated partnership company

421 Provision could be made whereby a company registered under the companies legislation which satisfies the criteria for incorporated partnerships and which desires to obtain the advantages of —

* not having to appoint directors; and

* being subject to a lesser degree of regulation could convert to an incorporated partnership company.

422 Eligibility to convert could be confined to those companies whose membership conformed to the appropriate maximum and minimum prescribed for an incorporated partnership company and which had the prescribed number of members resident in Australia or an external Territory. Companies with share capital would need to have all their issued shares fully paid.

Elimination of the category of exempt proprietary company

423 One of the principal incentives for the formation of exempt proprietary companies is the legislative relief afforded to such companies from full financial disclosure. An exempt proprietary company may choose either to file copies of its financial statements with its annual return or have its accounts audited. Given the facility for formation of an incorporated partnership company which does not have to lodge its accounts or have its accounts audited, it may be appropriate to discontinue the category of exempt proprietary companies.

424 Existing exempt proprietary companies would have the option to convert to an incorporated partnership company if they were eligible, or to remain under the Companies Act as either a non—exempt proprietary company or a public company, in either case with an obligation to lodge their audited accounts with their annual return.