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A Contract Law Problem Example

Question 1 Issue The issue is whether the contract entered into by Harry, a clerk in the factory office is enforceable against the company. **Rules** A company can enter into a contract by the virtue of **s124**. There are several ways a company can contract with the outsiders. One common way is to affix the company's common seal as illustrated in **Northside Developments Pty Ltd v Registrar-General**. However according to **s123(1)**, it is optional for the company to have a common seal. **S127(1)** of Corporations Act states that a common seal is not required if two directors or a director and a company secretary sign the document. There are two ways where individuals are capable of entering into contracts for the company. The first is the organic theory which refers to the organs of the company who are the directors, members and managing directors. This theory allows the company to contract directly under its name as illustrated in the case of **Lennard's Carrying Co Ltd v Asiatic Petroleum Co Ltd**. The second way is more common whereby a company (principal) is allowed to appoint agents to act on behalf of the company under **s126** of the Corporation Act. There are two types of authorities that agents are appointed through - actual and apparent or ostensible authority: **s126(1)**. An agent's actual authority may be given expressly or not by the principal. When an actual authority comes with express instructions, this is known as express actual authority. An actual implied authority is when an authority is not expressly agreed upon between the agent and the principal and the agent can enter into contracts like a person in the same position customarily can: **Hely-**

Hutchinson v Brayhead Ltd. An agent has apparent or ostensible authority when the person is held out by the company [s129(3)] and when outsiders have the impression that the agent has the authority to act on behalf of the company. However, this is not an actual authority but an appearance of the authority: **Freeman and Lockyear v Buckhurst Park Properties (Mangal) Ltd.** S128 and s129 of the Corporations Act allows the outsiders to make assumptions that the agent is complying with its company's constitution. The outsiders will rely in good faith on the representation and Doctrine of Estoppel will apply once representation is made. **Application** Based on the law and facts given, when Harry did not introduce his position to Mickey, Mickey assumes under s129 that Harry has the ostensible authority customary for a factory manager and has the authority to enter into the contract with him. However there is no actual authority in this case as Harry has not been given actual authority by the directors or John and the office he holds does not customarily provide him the authority to enter into a contract on behalf of the factory manager. There are no representation to suggest that the company gave Harry an appearance of authority. **Conclusion** To conclude, the contract is not enforceable against Alpha Ltd and Harry can be sued for breach of warranty of authority by Solder Ltd. **References** Lipton, P., Herzberg, ABE & Welsh, M., 2014. Understanding Company Law. (17th ed.). Australia: Thomson Reuters. Retrieved: 20 October 2014 Corporations Act 2001. Australian Corporations & Securities legislation. (2014 ed.). Australia: CCH. Retrieved: 20 October 2014

Question 2

1. Promotion is the period of time taken for the registration of the company. There are two types of promoters who take part in the formation, an active promoter and a passive promoter.

In **Twycross v Grant**, a person who actively engages in the formation of a new company is known as an active promoter and the promoter can act on behalf of the company. In **Tracy v Mandalay Pty Ltd**, a person who does not actively engaged in the incorporation process but stood to benefit from the profits is a passive promoter. The promoter may also participate in raising share capital to maintain the business of the proposed company. A promoter owes fiduciary duties to the proposed company and potential investors. As part of the fiduciary duties, the promoter is required to act in the best interests of the company, avoid any conflicting interests, ensure full disclosure of any interests (**Erlanger v New Sombrero Phosphate Co**) and any personal profits (**Gluckstein v**

Barnes) for contracts entered into. Based on the law and facts given, Larry is the party responsible for the incorporation of the company and thus satisfies the duties of an active promoter: **Twycross v Grant**. Larry owes the proposed company, Lifesaver Pty Ltd and its potential investors, fiduciary duties as mentioned above.

- b. Under **s131(1)** of the Corporation Act, the law states that a company is bound if the contract is entered before registration and ratified within an agreeable time by both parties. This is supported in the case of **Aztech Science Pty Ltd v Atlanta Aerospace**.

If the directors decided not to ratify Larry's lease, the promoter who entered the pre-registration contract on behalf of the company, which is Larry will be liable for any damages in virtue of **s131(2)** and **Bay v Illawarra Stationery Supplies Pty Ltd**. Larry will have to compensate both parties whereas Lifesaver Pty Ltd will not be affected. However Larry can be released from either or all part of the liability if the company sign a letter of release [**s132(1)**] from the liability clause but he will not be entitled to indemnity depending on the company [**s132(2)**].

- c. Lifesaver is a proprietary company as there's "pty" in the name: **s148(2)**. A proprietary company is prohibited from issuing shares to the public except to its existing shareholders or employees [**s113(3)**] whereas only public company can raise funds from the public by issuing a disclosure document.

Lifesaver Pty Ltd can consider issuing offers of securities that do not require disclosure documents as listed in **ss 708** and **708AA** such as small scale offerings which are personal offers to a small number of investors [**ss 708(1)-(7)**]; offers to sophisticated investors that deal with large offers [**s708(8)(a) and (b)**], offers to wealthy investors [**s708(8)(c) and (d)**] or offers to experienced investors [**s708(10)**].

- d. Lifesaver is a public company as there's no mention of "pty" or "proprietary" in the name. As only a public company can raise funds from the public, Lifesaver can do so by issuing a disclosure document or using documents that do not require disclosure documents as listed in **ss 708** and **708AA**.

The purpose of disclosure document is to ensure that relevant and accurate information is disclosed so investors

can make informed decision on whether to accept the offer. There are four types of disclosure document – prospectus, short form prospectus, profile statement and offer information statement. A prospectus is the most common type of disclosure document used in practice. **References** Lipton, P., Herzberg, ABE & Welsh, M., 2014. Understanding Company Law. (17th ed.). Australia: Thomson Reuters. Retrieved: 20 October 2014 Corporations Act 2001. Australian Corporations & Securities legislation. (2014 ed.). Australia: CCH. Retrieved: 20 October 2014

Question 3 Issue The issue is to explore the various method of raising funds and whether there is a need for disclosure document in raising \$11 million. **Rules** Companies can raise funds from the public provided that it is a public company and in order to raise funds, these companies are required to issue a disclosure document unless otherwise exempted to do so in **s708**. The purpose of disclosure document is to ensure that relevant and accurate information is disclosed so investors can make informed decision on whether to accept the offer. There are four types of disclosure document – prospectus, short form prospectus, profile statement and offer information statement. Profile statement is not an option as it is rarely used in practice. A prospectus is the most common type of disclosure document. A prospectus is required by the Corporations act to be prepared in a “clear, concise, and effective” way (**s715A**), including information required by the general disclosure test (**s710**), make specific disclosure required by **s711** and not be misleading or deceptive [**s728(1)**]. A short form prospectus is a reference to the full prospectus and used to assist the general public [**s712(1)**]. An offer information statement (OIS) is an alternative besides the prospectus if the amount raised in a company lifetime is \$10 million or less under **s709**. There are offers without a disclosure document as listed in **s708** and **s708AA**. One of the offers is small scale offerings that are personal offers of securities to a small number of investors. Disclosure document is generally not required unless it has breached the 20 investors ceiling and \$2 million ceiling [**s 708(3) and (4)**] within a 12 month period. **Application** Figment Ltd is a public company as there’s no mention of “pty” or “proprietary” in the name, thus it is able to raise funds from the public. Since the company does not want to prepare a prospectus, the only option is OIS. However OIS needs a disclosure document and the amount is capped at \$10 million. The company can consider the exemptions listed in **s708** and **s708AA** that do not need a disclosure document. If the offer is to be made to sophisticated investors, professional investors, senior managers or relatives, the company can consider the requirements for the respective documents. The company can consider using one or a combination of the documents in the listed exemptions to meet their needs. However because Figment is a public

company, potential investors would prefer to learn more about the company and the reason for the issue of shares, thus it would be recommended to prepare a disclosure document. Since the offer exceeds the \$10 million cap for using an OIS, Figment can consider using small scale offering for the remaining \$1 million since it did not breach the \$2 million breach. **Conclusion** To conclude, the best alternative is for Figment Ltd to use OIS in raising \$10 million securities and the remaining \$1 million using small scale offerings that do not require disclosure document under s708. **References** Lipton, P., Herzberg, ABE & Welsh, M., 2014. Understanding Company Law. (17th ed.). Australia: Thomson Reuters. Retrieved: 20 October 2014 Corporations Act 2001. Australian Corporations & Securities legislation. (2014 ed.). Australia: CCH. Retrieved: 20 October 2014 1