



Miles and Dowler, *A Guide to Business Law 21st edition*

Study Aid – Chapter summaries

Chapter summary – ch 5 – legal aspects of business (business structures and relationships)

The major types of business structure in use in New South Wales are Sole traders, Partnerships and Corporations. Trusts and associations may also be utilised – but in more specific circumstances. Within the various business organisations, certain structures may exist – for example, agencies and franchises.

A. Sole traders

A sole trader is an individual who owns the business and operates it by himself or herself.

B. Partnerships

1. Definition of partnership

A partnership is an association of two or more persons carrying on a business in common with a view to profit.

Partnerships are limited to 20 partners in New South Wales, unless they qualify as an “outside partnership” by virtue of being a certain type of trade or occupation (see *Corporations Regulations 2001* (Cth) reg 2A.1.01).

A partnership, often called a *firm*, must have a registered business name under the *Business Names Registration Act 2011* (Cth) if the firm uses a name other than that of the partners.

2. Elements of a partnership

A partnership has three elements:

- (1) the carrying on of a business;
- (2) in common; and
- (3) with a view of (to) profit.

Carrying on of a business means there must be something more than an isolated transaction.

3. Joint ventures

A joint venture may or may not be a venture, sometimes despite what the parties intend. The test is whether it is carrying on a business in common with a view to profit, and some other evidence of the existence of a partnership is



present. This can include a joint and equal sharing of profits and losses and a state of agency between the parties.

4. **Statutory presumptions**

The Act sets out certain presumptions that assist courts in determining whether or not there is a partnership:

- the mere fact of common ownership does not by itself prove that there is a partnership;
- the sharing of gross returns does not by itself prove there is a partnership; and
- the receipt by a person of a share in the profits of a business does not in itself prove a partnership.

5. **Relationship of partners to outsiders**

Several liability is separate or individual liability.

Joint liability is joint obligation of two or more persons irrespective of the individual contributions between these people.

Joint and several liability means that two or more persons can be sued together, or separately, for the whole of the debt, individual contributions being between those persons. Once a creditor or other person makes a choice of suing either one partner, or all, if he is unsuccessful, he cannot then seek another alternative.

6. **Incoming and outgoing partners.** An incoming partner is only liable for the debts of the partnership incurred from the date of entry.

An **outgoing partner** is only liable for the debts of the partnership incurred before the date of exit.

7. **Partnership by estoppel**

A person not otherwise a partner may become liable as a partner by estoppel where that person:

- represents that he/she is a partner; and
- a third party relies upon that observation.

8. **Relationship of partners to each other**

Partners have a fiduciary duty to each other. This means that the partner must:



- make full disclosure of relevant matters to other parties;
- not compete with the partnership;
- not make a secret profit or commission; and
- not use partnership property for private purposes.

Partners are free to agree as to the terms of the partnership agreement. In the absence of a specific agreement (verbal or written, formal or simple) the terms of the *Partnership Act 1892* apply (see also Chapter 5).

9. Dissolution of a partnership

Subject to any specific agreement between the parties, a partnership will be dissolved in the following circumstances:

- at the end of an agreed term or undertaking;
- upon reasonable notice;
- if a partner dies, or becomes bankrupt; or
- if the firm's enterprise becomes unlawful.

The court also has the power to dissolve a partnership on the following grounds:

- a partner becoming insane, or suffering a permanent incapacity;
- a partner guilty of conduct prejudicial to the business;
- wilful and persistent breach of the partnership agreement;
- where the business can only be carried on at a loss; and
- where it is just and equitable to dissolve the partnership.

10. Limited liability partnerships

Some States (including New South Wales, the governing legislation being *Partnership Act 1892*, Pt 3) allow the formation of a limited partnership, where the liability of the participants may be limited.

11. Incorporated limited partnerships

In 2004 in New South Wales a new Act, the *Partnership Amendment (Venture Capital Funds) Act 2004* was passed to create a new corporate entity to raise venture capital. It is known as an *incorporated limited partnership* (ILP) and has similar legal characteristics to a corporation. Like limited partnerships, ILPs are registered with the Office of Fair Trading, New South Wales.



12. **Business names**

A person or partnership may need to register a business name when they propose to operate a business using some other name besides their own. Registration is required under the *Business Names Registration Act 2011* (Cth), a new national Act administered by ASIC, taking over a responsibility formerly attended to by State and Territorial fair trading offices.

C. Trusts

A trust is an equitable creation where a person (the **trustee**) holds property or income for the benefit of another (the **beneficiary**). The usual parties in a trust are the settlor, trustee and beneficiary.

1. **Classifying trusts**

- express;
- implied; and
- constructive.

Resultant trusts can exist also in certain specific circumstances.

2. **Business trusts**

- trading trusts;
- unit trusts; and
- discretionary trusts.

D. Unincorporated associations

Traditionally, these are non-profit bodies, eg clubs.

E. Incorporated associations

Incorporated associations are associations that incorporate to avoid personal liability.

F. Companies

Companies are an artificial creation of the law and are now regulated by the *Corporations Act 2001* (Cth) (the Act). Companies in Australia are administered and registered by the Australian Securities and Investments Commission (ASIC). Upon registration, all companies in Australia receive a nine-digit number known as the ACN (Australian Company Number) and a Certificate of Registration. The ACN must be quoted on all company documents and correspondence, as well as displayed at



the registered office of the company.

1. **Types of companies**

- limited liability with shares;
- unlimited liability with shares;
- liability limited by guarantee (public);
- unlimited liability (public); and
- no liability (public) – mining only.

2. **Other company classifications**

- public companies; and
- proprietary companies (small or large) – see s 45A of the Act.

Note that proprietary companies may contain a single member and director which do not have the financial and reporting obligations of large or public companies.

3. **Advantages of a company**

- separate legal entity;
- members usually have limited liability for company debts; their liability extends only to any amounts unpaid on shares;
- perpetual succession – the company continues on in perpetuity, despite deaths of members and/or directors; and
- powers of an individual – see s 124 of the Act.

4. **Disadvantages of a company**

- compliance with the law;
- expensive to establish – currently the cost is approximately \$457;
- duties and obligations of directors and company officers; and
- financial disclosures in public and large companies.

5. **Company finance**

Public companies may raise funds by *equity* (selling shares) or *debt financing* (borrowing money). Only public companies are able to raise capital by the issue of shares. Companies have a number of options in respect of borrowing funds.



These include issue of debentures, charging company assets and borrowing funds by mortgaging company property (mortgage debentures).

6. Dividends

Companies may distribute profits to members by way of dividends in cash or bonus shares. Recent amendments to the Corporations Act have changed the circumstances under which a company may pay a dividend.

7. End of a company

- **Administration.**
- **Receivership.** Both receivership and administration offer the possibility of the company trading out of difficulties.
- **Liquidation (winding up).** Note that there are two types of winding up: creditors' voluntary and members' voluntary. In the latter, members may only vote to wind the company up if the company is "solvent" (s 95A of the Act defines insolvency as "an inability to pay debts as and when they fall due").
- **Voluntary deregistration** (s 601AA).

G. Business Structures: Agency

1. An **agent** is a person who has authority to create legal relations between a principal and third parties.
2. An **employee** may be an agent but not all agents are employees. An employee is generally employed under a contract for service and is subject to the employer's control.
3. An **independent contractor** can be an agent but not all agents are independent contractors.
4. A **trustee** holds property on trust for other persons. A trustee can be, but is not necessarily, an agent.

Creation of agency

1. Actual authority

Actual authority is given expressly (X authorises Y to collect his car from the parking station and drive to home) or by implication (Y has implied authority to buy petrol to carry out the task).

2. Apparent authority

This is the authority of a person to act as agent as it appears to reasonable persons. Sometimes called agency by *estoppel*.

3. Ratification



A principal can *ratify*, retrospectively approve, the unauthorised acts of an agent if the following conditions are satisfied the:

- agent intended to act on behalf of principal;
- principal existed at time of contract;
- principal had contractual capacity;
- principal ratifies whole of contract; and
- principal had full knowledge.

4. **Necessity**

An *agency of necessity* will arise where the “agent” can show *all* of the following:

- there was a real emergency;
- the agent acted in the interests of the “principal”;
- it was impossible or very difficult to contact the “principal”; and
- the “agent” had been entrusted with the “principal's” property.

Duties of an agent

The duties of an agent are based on contract and in tort and on the fiduciary relationship of the parties. A **fiduciary relationship** is a relationship based on trust. Duties include:

1. duty to **follow instructions**;
2. duty to **act in person**;
3. duty to **act in principal's interest**;
4. duty to **take care of principal's property** (duty of care is to do what is reasonable); and
5. duty to keep separate and proper accounts.

Rights of an agent

1. right to **remuneration**;
2. right to **indemnity and reimbursement**;
3. right to **a lien**; and
4. right of **stoppage in transit** delivery of goods dispatched on the principal's



behalf or to the principal.

Liability of agent to third parties in contract

1. Where an agent discloses agency, there is no liability in contract to the third party. Exceptions are:
 - agent agrees to be liable;
 - trade custom or usage;
 - principal does not exist; or
 - agent exceeds authority.
2. An agent who fails to disclose agency is personally liable on contract.
3. Doctrine of **undisclosed principal** allows third party, where agency not disclosed, to sue the agent, or principal – but not both.

Liability of an agent to third parties in tort

1. An agent who commits a tort can be sued by the injured party. If the agent is acting within authority, the agent can claim indemnity from the principal.
2. The injured party can sue the principal where the agent was acting within authority.
3. An agent may be liable for false representations in tort (see *Shaddock's case*) or under ss 28 and 29 of the Australian Consumer Law.

Breach of warranty of authority

An agent who wrongfully claims authority to act is liable in damages to a third party. The third party must prove:

- the agent represented that there was authority;
- the representation induced third party to act;
- the third party relied upon the representation; or
- the third party was unaware of the real situation.

Termination of agency

This occurs upon:

- agreement;
- revocation of authority where gratuitous;



- renunciation by agent where gratuitous;
- breach;
- expiry of agreed, or reasonable, time;
- death of either party (even if not known);
- insanity or bankruptcy; or
- normal contractual terminations.

Types of agent

1. Classification

- A **special agent** is authorised to do only one task.
- A **general agent** is authorised to act in a class of transactions of a continuing nature, or in one transaction only as part of a trade or profession.
- A **general agent** has authority to do all things that an agent of that particular type normally can.
- A **universal agent** can do all things that the principal can legally do. A universal agency is usually created by Power of Attorney.

2. Specific types of agent:

- **Mercantile** agents;
- **Del credere** agents; and
- **Brokers**.

Note that a **mercantile agent** is a person entrusted with the possession of the principal's goods. A mercantile agent can transfer good title to the goods to a bona fide purchaser without notice even when acting outside authority.

H. Business structures: Franchising

1. The Australian Competition and Consumer Commission (ACCC) plays a pivotal role in overseeing potential franchises that may breach the *Competition and Consumer Act 2010* (Cth).
2. In consultation with the ACCC, the Franchising Code of Practice has been developed to regulate the rights and obligations of the franchisor and franchisee. Of particular importance are the disclosure documents, which require franchisors to make full and detailed disclosure of all matters relating to the franchise, including financial statements, marketing support, business plans and



leaseholds.

3. The Franchising Code of Conduct has been amended, effective from July 2010 to all new franchises and renewals after that date. See [5.1310] for further details of changes to the existing Code.
4. Prospective franchisors/franchisees who seek information prior to embarking on a franchised enterprise, whether to purchase one or to create one from an existing business, should contact the peak franchise body in Australia, the Franchise Council of Australia., especially in the light of recent changes to the Code.
5. Disputing parties also have the option of seeking mediation where they are unable to resolve their disputes.